



March 2024

DEFENSE CONTRACTING

DOD Should Encourage Greater Use of Existing Expertise to Review Indemnification Requests

Accessible Version

GAO Highlights

Highlights of [GAO-24-106403](#), a report to congressional committees

Why GAO Did This Study

Recently, DOD has experienced challenges indemnifying—or providing financial protection to—contractors working on certain weapon systems. A congressional report expressed concern that DOD’s application of indemnification laws and an increase in programs with unusually hazardous risks could affect DOD’s ability to field advanced weapon systems.

The report included a provision for GAO to report on DOD’s indemnification of contractors against unusually hazardous risk. GAO’s report examines (1) how DOD has indemnified risk related to contracts over the past 15 years and how it makes those decisions, (2) how defense contractors obtain insurance and the risk factors that influence insurance coverage decisions, and (3) what indemnification challenges, if any, DOD and contractors have experienced and may experience in the future.

GAO analyzed available indemnification data from six selected DOD components—including the military departments, Missile Defense Agency, and Defense Logistics Agency—from 2008 through 2022; reviewed government-wide and DOD indemnification policies and regulations; and interviewed officials at DOD, five selected defense contractors, and four selected insurers.

What GAO Recommends

GAO is recommending that DOD encourage contracting officials to consider using existing expertise within DCMA to improve the indemnification request review process. DOD agreed with GAO’s recommendation.

View [GAO-24-106403](#). For more information, contact Shelby S. Oakley at (202) 512-4841 or oakleys@gao.gov.

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DEFENSE CONTRACTING

DOD Should Encourage Greater Use of Existing Expertise to Review Indemnification Requests

What GAO Found

When a contract involves unusually hazardous or nuclear risk, which insurers may decline to cover, the government may indemnify defense contractors. This indemnification financially protects contractors from liability arising from a catastrophic incident. Contractors report that it also incentivizes them to complete work that would otherwise be financially untenable, as an incident could exceed the limit of a contractor’s commercial insurance policy.

Financial Protection Provided by Commercial Insurance and Government Indemnification

Type of financial protection	Coverage provided
Commercial insurance	• Coverage provided for claims involving covered contractor products, subject to the limit of the insurance policy
Government indemnification	• Coverage provided for claims, losses, or damages that arise out of or result from a risk that the contract defines as unusually hazardous or nuclear, and is not compensated for by insurance or other means

Source: GAO analysis of aviation insurance industry and defense contractor information. | GAO-24-106403

^aIndemnification coverage is limited in some circumstances. For example, contractors will not be indemnified against government claims against the contractor or for losses or damages affecting the contractor’s property, if the claim, loss, or damage is caused by willful misconduct or lack of good faith on the part of certain contractor officials.

Indemnification requests are infrequent and generally approved. The Department of Defense (DOD) components that GAO reviewed reported receiving only about 350 indemnification requests over the past 15 years. Components’ processes for evaluating indemnification requests varied. GAO found that contracting officials at some components were unaware of or did not use a specialized insurance review team within the Defense Contract Management Agency (DCMA) to assist in their evaluations. Components that did use this team found the reviews helpful. Lack of knowledge and use of this expertise means components may be missing an opportunity to facilitate the review process.

Defense contractors generally obtain coverage for their work from multiple multi-national insurers. Insurers develop a comprehensive risk profile on contractors to determine what coverage they will provide. According to industry representatives, world events and market volatility in recent years shrunk the insurance market and reduced coverage available to contractors. Insurer representatives that GAO interviewed stated that as a result, government indemnification is an increasingly important factor they consider when providing coverage to defense contractors.

DOD experienced challenges negotiating indemnification requests related to weapons carried on *Virginia* class submarines. Those challenges were resolved, but officials could not estimate the impact of these negotiations due to pre-existing program delays. Additionally, while contractors have expressed concern about not defining unusually hazardous risk in regulation, DOD officials noted the importance of maintaining the flexibility to consider indemnification requests based on each component’s unique mission profile.

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Abbreviations

CIPR	contractor insurance/pension review
CPS	Conventional Prompt Strike
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DLA	Defense Logistics Agency
DOD	Department of Defense
DPC	Defense Pricing and Contracting
FAR	Federal Acquisition Regulation
NASA	National Aeronautics and Space Administration
MDA	Missile Defense Agency
OUSD(A&S)	Office of the Under Secretary of Defense for Acquisition and Sustainment
USD(A&S)	Under Secretary of Defense for Acquisition and Sustainment
USTRANSCOM	United States Transportation Command

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March 7, 2024

Congressional Committees

The Department of Defense (DOD) uses contractors for some work that may involve unusually hazardous risk, such as the construction of nuclear-powered vessels. Contractors can mitigate some of this risk by purchasing commercial insurance coverage. However, sometimes contractors also rely on government indemnification—a process in which the government provides protection to a contractor for financial liability arising from a catastrophic incident—to cover risk beyond available insurance limits.¹

The Joint Explanatory Statement accompanying the National Defense Authorization Act for Fiscal Year 2022 expressed concern that DOD’s application of indemnification laws, coupled with an increase in programs that include unusually hazardous risks, could adversely impact DOD’s ability to field advanced weapons systems. The statement included a provision for us to report on DOD’s indemnification of contractors for contracts involving unusually hazardous risk under Public Law 85-804 and title 10 section 3861 of the U.S. Code.² This report examines (1) how DOD has indemnified risk related to contracts over the past 15 years and how it makes indemnification decisions, (2) how defense contractors obtain insurance and the risk factors that influence insurance coverage decisions, and (3) what indemnification challenges DOD and contractors have experienced and may experience in the future.

¹For the purposes of this report, we refer to “government indemnification” as indemnification that occurs using two primary statutory indemnification authorities—title 10, section 3861 of the U.S. Code, and title 50, chapter 29 of the U.S. Code—and their implementing regulations and policies. Title 50, chapter 29 of the U.S. Code refers to authorities originally enacted by Public Law 85-804. For the purposes of this report, we refer to the authorities outlined in title 50, chapter 29 of the U.S. Code as Public Law 85-804 authorities. Indemnification may also be authorized by other statutes or regulations which were not included in the scope of our review.

²The Joint Explanatory Statement included a provision for GAO to submit a report on policy and recommendations related to the department’s indemnification of programs that include unusually hazardous risks, and to review how the military services and other DOD components use the indemnification authorities outlined in title 10 section 2354 of the U.S. Code, and title 50 chapter 29 of the U.S. Code. Title 10, section 2354 of the United States Code was renumbered to title 10, section 3861 of the U.S. Code. See William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-263, § 1836(b) (2021).

To determine how DOD has indemnified risk related to contracts over the past 15 years and made decisions on indemnification, we collected available data on the number of indemnification requests received by selected DOD components from fiscal years 2008 through 2022.³ The seven components we selected were identified as receiving indemnification requests in a July 2022 report to Congress on indemnification prepared by Defense Pricing and Contracting (DPC), an office within the Office of the Under Secretary of Defense for Acquisition and Sustainment (OUSD(A&S)).⁴ The identified components were as follows:

- Air Force,
- Army,
- Defense Contract Management Agency (DCMA),
- Defense Logistics Agency (DLA),
- Missile Defense Agency (MDA),
- Navy, and
- United States Transportation Command (USTRANSCOM).

Initial data collection revealed that data on indemnification requests, approvals, and expenditures vary widely across DOD. Notably, half of the services and components that reported having data in our scope could not produce information from all years requested, and some were not able to produce data related to all legal authorities requested. We discuss these limitations in our report. Additionally, not all components we selected reported receiving indemnification requests under the authorities in our scope in the past 15 years. For example, USTRANSCOM provided

³For the purposes of this report, an indemnification request occurs when a contractor submits a request package to include an indemnification clause into a contract for review and approval to a DOD component. Parts of the Navy's indemnification data were provided in calendar years instead of fiscal years. As such, reported totals are an estimate.

⁴The National Defense Authorization Act for Fiscal Year 2022 contained a provision directing the Secretary of Defense to provide a review and briefing to the congressional defense committees on DOD's implementation of certain statutory and regulatory authorities related to indemnifying contractors for performing on a contract that includes unusually hazardous risk. See Pub. L. No. 117-81, § 1684(c) (2021). In July 2022, the Secretary of Defense provided a report in lieu of this briefing.

data on 283 indemnification requests using an authority outside the scope of our review.⁵

We also reviewed policy and guidance from DOD, the selected components, and the Federal Acquisition Regulation (FAR) on how DOD processes indemnification requests, including approvals and denials. We interviewed officials involved in the indemnification request evaluation process at six of the selected components, as well as officials at DPC. We did not interview officials at USTRANSCOM since their indemnification requests were outside the scope of our review. Additionally, we interviewed officials at the National Aeronautics and Space Administration (NASA)—which also indemnifies contractors for contracts involving unusually hazardous risk—to compare indemnification processes. Finally, we reviewed NASA’s FAR supplement and internal guidance.

To describe how defense contractors obtain insurance and the risk factors that influence insurance coverage decisions, we selected a nongeneralizable sample that represented the top five major defense contractors to which DOD obligated the most funding in 2022. We also selected a nongeneralizable sample of four commercial insurers based on geographic balance, considering each of the regions from which selected contractors indicated they purchase insurance. We interviewed representatives from the selected contractors and insurers, two industry groups representing defense contractors and insurers, and a major insurance broker to discuss the process by which contractors purchase aviation insurance, how coverage decisions are made, and the state of the insurance market.

To describe what indemnification challenges DOD and contractors have experienced and may experience in the future, we reviewed the statutes, regulations, and policies that govern the use of indemnification—such as Public Law 85-804, Executive Order 10789, and implementing FAR and Defense Federal Acquisition Regulation Supplement (DFARS) provisions—to identify limitations. We also interviewed officials at the selected DOD components, defense contractors, and insurers to gain perspective on the effectiveness of the current indemnification process, gaps in existing authorities, limitations or challenges, and options to improve the indemnification process. Finally, we interviewed the Conventional Prompt Strike (CPS) and *Virginia*-class submarine program offices, which were identified in DOD’s documentation as experiencing challenges related to recent indemnification requests for unusually

⁵For the authority used by USTRANSCOM to grant indemnification requests, see 49 U.S.C. § 44305.

hazardous risk. We interviewed officials at the selected program offices to discuss the nature of the challenges they experienced, steps that the components have taken to mitigate those challenges, and the effect of those challenges on program outcomes.

We conducted this performance audit from November 2022 to March 2024 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

When a contract involves an unusually hazardous or nuclear-related risk, the federal government may provide indemnification, or financial protection, to defense contractors for these risks. DOD's primary indemnification authorities for unusually hazardous risks do not define what constitutes such a risk, providing DOD components with flexibility to determine what types of risks to indemnify using these authorities. Unusually hazardous risks can include things such as burning, explosion, detonation, flight or surface impact, or toxic or hazardous material release. Work involving unusually hazardous or nuclear risk may result in a potentially catastrophic incident. Insurers, contractors, and the government cannot consistently model the probability or potential damages of such an incident. Accordingly, when contractors accept work involving unusually hazardous or nuclear risk, they face potentially existential financial risk, as a single incident could exhaust a contractor's available insurance limits and other resources. In this way, government indemnification incentivizes defense contractors to perform work that would otherwise be financially untenable.

A contractor can seek indemnification coverage through an indemnification request. An indemnification request occurs when a contractor submits a request package to include an indemnification clause into a contract for review and approval to a DOD component. Coverage is not conferred until the request is approved and an indemnification clause is incorporated into the contract. Indemnification claims are separate from requests and are paid only if an indemnifiable incident has taken place. In these cases, the government assumes potentially unlimited liability when indemnifying a contractor for unusually hazardous risk in the event of a catastrophic incident. In addition to the

magnitude of this potential government liability, the duration of indemnification agreements can exceed a contract's period of performance. This is because claims related to activity that took place during that period may take years to be resolved. For example, as recently as April 2023, the government, pursuant to an indemnification provision, was ordered to reimburse contractors for certain costs related to environmental cleanup efforts resulting from World-War-II-era contracts to produce aviation fuel.⁶

Authorities and Regulations Governing Contractor Indemnification

The government's authority to indemnify contractors for unusually hazardous or nuclear risks to facilitate national defense is derived from two main statutory authorities. The authority is implemented in the FAR and DFARS.⁷ See table 1.

⁶See *Shell U.S.A. Inc. v. United States*, 165 Fed. Cl. 553 (2023); appeal dismissed; 2023 WL 5814406 (Fed. Cir. 2023). The contracts at issue in this case did not use the indemnification authorities discussed in this report.

⁷For example, see FAR 50.104-3: Special Procedures for Unusually Hazardous or Nuclear Risk; DFARS 235.070 Indemnification against unusually hazardous risks; DFARS 250.104-3-70 Indemnification under contracts involving both research and development and other work; DFARS 252.235-7000 Indemnification under 10 U.S.C. 3861 (2354) – Fixed Price; and DFARS 252.235-7001 Indemnification under 10 U.S.C. 3861 (2354) – Cost Reimbursement.

Table 1: DOD’s Primary Statutory and Executive Order Authorities for Unusually Hazardous and Nuclear Risk Indemnification and Implementing Regulations

Primary authorities	Description	Implementing regulations
Public Law 85-804 and Executive Order 10789	Public Law 85-804 allows the President to authorize certain government entities to enter into, amend, and modify contracts when the President deems that doing so will facilitate national defense without regard to other related provisions of law. In Executive Order 10789, the President authorized the Department of Defense (DOD) to enter into, amend, and modify such contracts within the limits of the amounts appropriated and contract authorization provided, when an authorized official determines that doing so will facilitate national defense. ^a The current version of the executive order authorizes DOD to indemnify contractors, outside the limits of the amounts appropriated and contract authorization provided, against certain claims or losses resulting from risks that the contract defines as unusually hazardous or nuclear in nature. ^b Indemnification granted under this provision may not include certain claims or losses caused by willful misconduct or lack of good faith on the part of the contractor’s directors, officers, or principal officials.	Federal Acquisition Regulation 50.104-3 Special Procedures for Unusually Hazardous or Nuclear Risk prescribes standards and procedures for exercising residual powers under Public Law 85-804 and outlines the information that should be included in contractor indemnification requests and the process by which DOD components should evaluate the request.
10 U.S.C Section 3861	Authorizes the Secretary of a military department to approve indemnification of a contractor under a research or development-based contract against certain claims and loss or damage to property from a risk that the contract defines as unusually hazardous, but only to the extent that they arise out of the direct performance of the contract and to the extent not compensated by insurance or otherwise.	Defense Federal Acquisition Regulation Supplement 235.070-1 Indemnification Under Research and Development Contracts outlines the nature of claims and losses for which DOD may indemnify contractors and prescribes that the indemnified risks should be defined, approved, and included in the contract.

Source: GAO analysis of statutory, regulatory, and executive order information. | GAO-24-106403

^aSee Exec. Order 10789, 23 Fed. Reg. 8897 (Nov. 14, 1958). The authorized officials include the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, or the duly authorized representative of any such Secretary.

^bSee Exec. Order 11610, 36 Fed. Reg. 13755 (July 22, 1971) (amending Executive Order 10789). The original version of Executive Order 10789 authorized DOD to enter into, amend, or modify contracts within the limits of the amounts appropriated and the contract authorization provided. Executive Order 11610 amended Executive Order 10789 to specifically exempt qualifying indemnification contract provisions from these limits.

We reported in November 1994 that each agency using the indemnification authority under Public Law 85-804, including DOD, was required to report its actions in an annual report to Congress.⁸ If an action involved actual or potential costs in excess of \$50,000, the report was to include the contractor’s name, actual or estimated potential costs, a description of property or service involved, and circumstances justifying

⁸GAO, *Environmental Cleanup: Defense Indemnification for Contractor Operations*, NSIAD-95-27 (Washington, D.C.: Nov. 25, 1994).

the action.⁹ In that report, we also found that agencies reported the number of contracts with contingent liability provisions by contractor.¹⁰ However, the congressional reporting requirement on DOD's use of indemnification authority was repealed in 1998.¹¹ Similarly, agencies entering into indemnification agreements are generally not required by the Office of Management and Budget to report the resulting potential liabilities under current annual financial reporting requirements. The Office of Management and Budget requires agencies to record contingent liabilities—like indemnification—if a past event occurred, a future outflow of resources is probable, and the outflow is measurable; and to disclose liabilities if there is a reasonable possibility a loss to the government may have been incurred.¹² If a contingent liability does not meet this criteria, and there is no reasonable possibility a loss has occurred, it is not reported.

Role of Insurance for Defense Contractors

Purchasing insurance allows defense contractors to manage risk by providing compensation for certain losses or expenses. Contractors purchase commercial insurance, often with the assistance of a broker, which generally covers both their commercial and government business under a single policy. These policies can therefore provide at least some coverage for certain risks related to covered weapon systems. Further, weapon system contractors may be covered by multiple types of insurance at various points in the system's life cycle. For example, a contractor's cargo or transportation insurance may provide coverage when a weapon is being transported between facilities. A contractor's aviation insurance may also provide coverage after the weapon system is delivered to the government. Indemnification clauses can provide coverage for some types of risk that could also be covered by insurance

⁹The statutory requirement to report information allowed agencies to omit information if disclosing it would be detrimental to national security.

¹⁰A contingent liability is a set of circumstances or situation that involves uncertainty about a financial loss.

¹¹See Federal Reports Elimination Act of 1998, Pub. L. No. 105-362, § 901(r)(1)(A). Although Congress repealed the reporting requirement, Executive Order 10789 was not amended to repeal the corresponding requirement. Officials from DPC stated that, given the statutory repeal of the requirement, they do not coordinate a report across DOD as described in the executive order, but will report on indemnification if requested by Congress.

¹²Office of Management and Budget, *Office of Management and Budget Circular No. A-136, Section II.3.2.4.*

policies.¹³ Notably, however, insurers exclude some types of work, such as nuclear-related work, from the coverage they provide.

Major events or losses, such as those related to war or aircraft groundings, also affect the insurance market. Specifically, industry representatives explained that when large losses occur, the overall coverage that insurers are willing to provide to defense contractors can decrease, while prices may increase. We previously reported that fragile and capacity-constrained markets are risks to the defense industrial base.¹⁴ In this report, we found that the aviation insurance market has shrunk in recent years due in part to global events and there are a limited number of insurers capable of providing coverage to defense contractors.

Indemnification Requests Are Infrequent and Contracting Officials Are Not Consistently Using Available Resources to Evaluate Requests

DOD components reported that they have received approximately 348 indemnification requests over the past 15 years, but such requests occur on only a fraction of DOD's contracting activity. These requests were almost always approved. The components we reviewed do not collect standardized data or information on indemnification. As such, the data reported to us on indemnification was incomplete. Additionally, the components' processes to evaluate indemnification requests and components' decision authorities also vary based on the statutory authority under which the request was made. We found that contracting officers often did not leverage the expertise of a specialized insurance unit within DCMA that can assist with indemnification request reviews.

Indemnification Requests Are Rare, Generally Approved, and Have Not Resulted in Payment

Over the past 15 years, selected DOD components reported that contractors have made about 348 indemnification requests. The requests covered events like rocket launches, goods or services used in support of

¹³Throughout this report we use the terms insurance, insurance coverage, insurance market, etc. to refer to aviation insurance, because in general, items for which contractors may request indemnification for unusually hazardous risk—such as missiles, satellites, etc.—are insured by contractors with aviation insurance.

¹⁴GAO, *Defense Industrial Base: DOD Should Take Actions to Strengthen Its Risk Mitigation Approach*, [GAO-22-104154](#) (Washington, D.C.: July 7, 2022).

those launches, and contracts with nuclear elements, among others. As previously discussed, an indemnification request occurs when a contractor submits a request to a DOD component to include an indemnification clause into a contract. Indemnification *claims* are separate from requests and are paid only if an indemnifiable incident has taken place.¹⁵ Accordingly, indemnification requests are not associated with expenditures. Conversely, indemnification claims may have associated expenditures in the event of an indemnifiable incident. However, none of the components reported paying any indemnification claims in the past 15 years under the indemnification authorities discussed in this report, and as a result, none reported any expenditures.

The reported indemnification requests occurred on a small proportion of DOD’s overall contracts. For example, the Navy reported receiving the most indemnification requests—approximately 281 between 2008 and 2022—but in the same period had over 3.6 million contract actions.¹⁶ Additionally, while four components reported receiving indemnification requests, the Army, DCMA and TRANSCOM did not receive any indemnification requests from contractors.¹⁷ Components that received indemnification requests generally approved them (see table 2).

Table 2: Estimated Total Indemnification Requests Reported by Selected DOD Components, Fiscal Years 2008-2022

Category	Navy	Air Force	Missile Defense Agency	Defense Logistics Agency
Number requested under Public Law 85-804 and Executive Order 10789	261	23	0	30
Number requested under 10 U.S.C. Section 3861	20	2	12	0
Total number of requests	281 ^a	25 ^b	12	30
Request outcomes (as of September 2023): Approved requests	265 ^c	24	11	28
Request outcomes (as of September 2023): Pending requests	0	1	1	2

¹⁵The FAR and DFARS state that claims, losses, or damages must not result from a lack of good faith or willful misconduct by certain contractor officials.

¹⁶Contract action means any oral or written action that results in the purchase, rent, or lease of supplies or equipment, services, or construction using appropriated dollars over the micro-purchase threshold, or modifications to these actions regardless of dollar value.

¹⁷The Army initially reported receiving one indemnification request between 2008 and 2022, but the request was subsequently rescinded and was never fully evaluated by the component. DCMA also did not receive indemnification requests, as officials told us they are only involved in performing insurance reviews for requests received by other components.

Letter

Category	Navy	Air Force	Missile Defense Agency	Defense Logistics Agency
Request outcomes (as of September 2023): Denied requests	0 ^d	0	0	0
Indemnification expenditures	\$0	\$0	\$0	\$0

Source: GAO analysis of Department of Defense (DOD) data. | GAO-24-106403

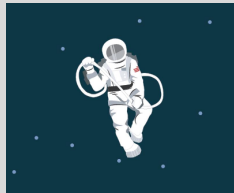
Notes: The numbers in this table represent estimates. Additionally, three components—the Army, United States Transportation Command, and the Defense Contract Management Agency—did not report any indemnification requests or expenditures from indemnification claims under these authorities and are not included in the analysis table.

^aOf the 261 Navy requests under Public Law 85-804 and Executive Order 10789, 38 were classified requests. Of the 20 Navy requests under 10 U.S.C. Section 3861, four were classified requests. Additionally, Navy officials told GAO that some requests from 2008 were missing from the data the Navy provided.

^bThe Air Force provided data only for the years 2014-2022.

^cThe outcomes for requests to the Navy do not add up to the total number of requests because approval information was not available for the 15 unclassified requests made under title 10, section 3861 of the U.S. Code.

^dThe Navy originally reported denying three indemnification requests. The Navy later approved two of these requests but was unable to confirm the status of the third request. Therefore, GAO did not include this denial in the outcomes.



Indemnification Requests at NASA

Other agencies also indemnify contractors against unusually hazardous or nuclear risk. For example, NASA reported having about 12 indemnification requests over the past 15 years. Like DOD, NASA does not maintain centralized data on indemnification.

Source: GAO analysis of National Aeronautics and Space Administration (NASA) information: GAO (icon). | GAO-24-106403

The data DOD provided to us were not complete. For example, Navy officials noted their 2008 data for requests under Public Law 85-804 are likely incomplete. Similarly, the Air Force was able to provide data only back to 2014, though we requested information back to 2008. Air Force officials explained this is because accessing any earlier data would require a manual data call. Additionally, only the Navy was able to provide information on classified indemnification requests it had received. Navy officials explained that there may be additional data on classified requests, but there is no central reporting of the information. Given the missing data from components from certain periods and for classified requests, there are likely more indemnification requests than are reflected in table 2.

DOD's potential liability from indemnification is unknown. As previously noted, DOD has not been required to report indemnification information to Congress since 1998 and the current annual financial statement reporting requirements for contingent liabilities do not capture DOD's potential financial exposure from future indemnification claims. Additionally, indemnification provisions are not required by the FAR or the DFARS to include a dollar ceiling on the amount of liability assumed by the government. Therefore, it is not known how much potential liability DOD maintains from indemnification. However, officials from DPC explained that if an indemnification claim occurred and DOD had available funds to cover the cost, the agency could pay for it, but if an indemnification claim exceeded available funds, DOD would likely seek a special appropriation.

Component officials we spoke with said they do not collect indemnification data in a standardized way. Agency officials explained they do not have a need to standardize data collection because (a) they receive few indemnification requests from contractors, (b) there are not generally requests for indemnification data, and (c) the data are not used internally. Officials from DPC added that because there is no system to track indemnification data, the data are manually pulled when reporting is requested. DPC officials added they do not have plans to track indemnification information in the future since DOD has not needed indemnification information internally.

Components' Processes for Evaluating Indemnification Requests Vary

DOD components have processes and guidance that govern their review of indemnification requests. Overall, the process by which DOD components evaluate an indemnification request and the decision authority to approve or deny indemnification requests depends on the statutory authority under which the request is made—Public Law 85-804 and Executive Order 10789 or 10 U.S.C. Section 3861, as discussed above.¹⁸ Specifically, the FAR outlines procedures for reviewing an indemnification request for unusually hazardous and nuclear risks. This procedure includes what documents and information a contractor's request package should include and when to send the request package to various stakeholders such as agency legal counsel, program personnel, and the approving official. Contractors should include information in their requests including: (a) an identification and definition of the unusually

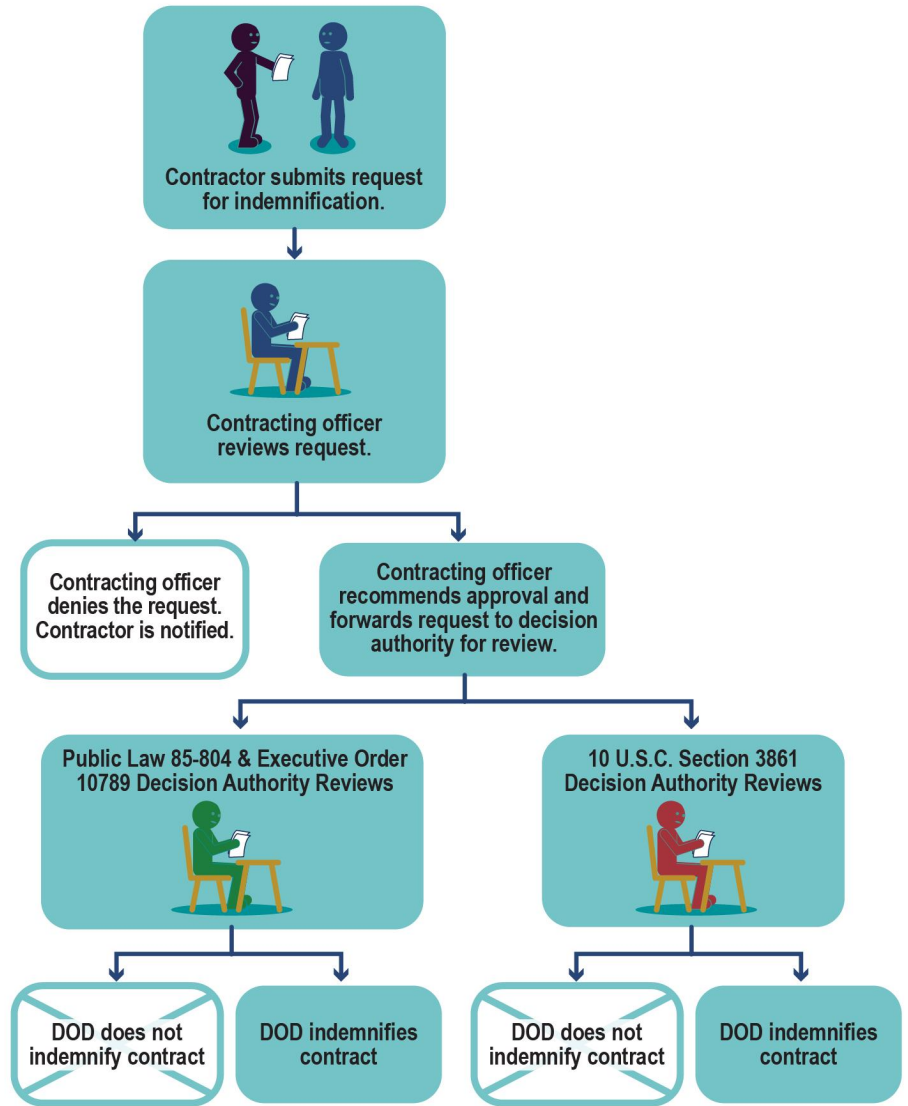
¹⁸Navy officials explained that indemnification requests on classified contracts may not go through normal review procedures due to the sensitive nature of the information.

hazardous or nuclear risk and description of the contractor's exposure, and (b) a statement of all insurance coverage applicable to the risks to be defined in the contract as unusually hazardous or nuclear, among other things.¹⁹ Figure 1 describes the general processes used to evaluate and grant or deny indemnification requests.²⁰

¹⁹FAR 50.104-3: Special Procedures for Unusually Hazardous Risk.

²⁰For the purposes of this report, an indemnification request occurs when a contractor submits a request package to include an indemnification clause into a contract for review and approval to a DOD component.

Figure 1: General Framework of Indemnification Request Review Process



Source: GAO analysis of Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Department of Defense documentation; GAO (icons). | GAO-24-106403

Accessible Text for Figure 1: General Framework of Indemnification Request Review Process

- Contractor submits request for indemnification.
 - Contracting officer reviews request.

- Contracting officer denies the request. Contractor is notified.
- Contracting officer recommends approval and forwards request to decision authority for review.
 - Public Law 85-804 & Executive Order 10789 Decision Authority Reviews
 - DOD does not indemnify contract
 - DOD indemnifies contract
 - 10 U.S.C. Section 3861 Decision Authority Reviews
 - DOD does not indemnify contract
 - DOD indemnifies contract

Source: GAO analysis of Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Department of Defense documentation; GAO (icons). | GAO-24-106403

For indemnification requests on research and development contracts made under 10 U.S.C. Section 3861, DOD provides additional detail in the DFARS. Specifically, the DFARS outlines the decision authority for requests made under 10 U.S.C. Section 3861, which differs from the FAR guidance applied to contracts indemnified under Public Law 85-804 (see table 3).²¹

Table 3: Unusually Hazardous and Nuclear Indemnification Request Approval Authorities

na	Indemnification decision authority	Indemnification decision authority
DOD component	Public Law 85-804 and Executive Order 10789	10 U.S.C. Section 3861 (research & development contracts)
Navy	Secretary of the Navy	Deputy Assistant Secretary of the Navy for Procurement
Air Force	Secretary of the Air Force	Air Force Materiel Command and Air Force Life Cycle Management Center Senior Contracting Officials
Army	Secretary of the Army	Secretary of the Army
Missile Defense Agency	<\$75k: Director of Missile Defense Agency >\$75k: Under Secretary of Defense for Acquisition and Sustainment (USD(A&S))	Director of Missile Defense Agency

²¹DFARS 235.070 Indemnification against unusually hazardous risks; DFARS 250.104-3-70 Indemnification under contracts involving both research and development and other work; DFARS 252.235-7000 Indemnification under 10 U.S.C. 3861 (2354) – Fixed Price; and DFARS 252.235-7001 Indemnification under 10 U.S.C 3861 (2354) – Cost Reimbursement.

na	Indemnification decision authority	Indemnification decision authority
DOD component	Public Law 85-804 and Executive Order 10789	10 U.S.C. Section 3861 (research & development contracts)
Defense Logistics Agency	<\$75k: Director of Defense Logistics Agency >\$75k: USD(A&S)	USD(A&S) ^a
United States Transportation Command	<\$75k: Commander of United States Transportation Command >\$75k: USD(A&S)	USD(A&S) ^a

Source: GAO analysis of Department of Defense (DOD) documents, Federal Acquisition Regulations, and the Defense Federal Acquisition Regulation Supplement. | GAO-24-106403

^aInformation about approval authorities for the Missile Defense Agency, Defense Logistics Agency, and United States Transportation Command was supplemented by Defense Pricing and Contracting officials.

Not all components received requests under both authorities. Of the four components that reported receiving indemnification requests, only the Navy, Air Force, and MDA reported adding indemnification clauses to research and development contracts under 10 U.S.C. Section 3861 (see table 4). However, these accounted for only 34 out of 348 total reported requests.



Indemnification Authorities at NASA

Other agencies draw on some of the same indemnification authorities. For example, NASA can indemnify contractors for damages and losses arising from unusually hazardous activities and risks during performance of the contract under Public Law 85-804 and Executive Order 10789. Officials stated that NASA has granted indemnification requests under this authority and follows the FAR, in addition to special procedures for unusually hazardous or nuclear risk in the NASA FAR Supplement. The NASA administrator makes the final indemnification decision.

Source: GAO analysis of National Aeronautics and Space Administration (NASA) information; GAO (icon). | GAO-24-106403

Table 4: Authorities Used by DOD Components with Unusually Hazardous and Nuclear Indemnification Requests, Fiscal Years 2008-2022

DOD component	Authority: Public Law 85-804 and Executive Order 10789	Authority: 10 U.S.C. Section 3861
Navy	authority used	authority used
Air Force	authority used	authority used
Missile Defense Agency	authority not used	authority used
Defense Logistics Agency	authority used	authority not used

✓ = authority used; - = authority not used

Source: GAO analysis of Department of Defense (DOD) data. | GAO-24-106403

Although the FAR and DFARS provide a general process for assessing indemnification requests, some of the implementation details vary by component. For example, Navy officials explained the Navy maintains two separate processes to review nuclear indemnification requests and unusually hazardous risk indemnification requests. Specifically, officials explained the Navy processes its nuclear indemnification requests made under Public Law 85-804 on an annual basis and any other requests on a case-by-case basis outside of that annual cycle. After processing annual requests, the Navy issues a memorandum outlining the nuclear programs for which the indemnification requests were approved. The annual memorandum allows for indemnification of new contracts for the identified programs. As such, only new contracts are included under the annual memorandum, but programs may have existing contracts containing indemnification provisions approved in a prior year's memorandum. Similarly, the Army Federal Acquisition Regulation Supplement requires additional information to evaluate research and development indemnification requests. Such information includes the clause showing the contract is for research and development and the reasons indemnification would be in the government's interest, among other things.²² Components' officials also cited different processing times for evaluating requests, ranging from an estimate of 3-6 months at MDA to an estimate of 8 months to a year at the Air Force.

Some components have additional guidance on the indemnification request review process, while others have no supplemental guidance. For instance, the Air Force has an indemnification guide that provides insight for the acquisition community into determining what constitutes an unusually hazardous or nuclear risk and a checklist for reviewing information submitted by the contractor. DLA also has an indemnification guide that highlights what indemnification is and when it is used, directs contracting officers to the relevant FAR clauses, and lays out the internal review process to evaluate and potentially approve an indemnification request. Other components—such as the Navy—did not provide additional guidance and indicated that the FAR provided sufficient information for processing indemnification requests. Primary indemnification authorities do not require components to provide additional guidance.

²²Army Federal Acquisition Regulation Supplement 5135.070-1 Indemnification under research and development contracts.

DOD Components Do Not Consistently Leverage Available Expertise

Two of the four DOD components that received indemnification requests did not leverage available expertise within DCMA to help evaluate those requests. The DFARS explains that the administrative contracting officer is responsible for determining the need for a contractor insurance/pension review (CIPR). It also explains that DCMA insurance/pension specialists and Defense Contract Audit Agency auditors assist administrative contracting officers in making these determinations and conduct CIPRs when needed.²³ DCMA Manual 2201-01 states that DCMA is the executive agent responsible for the performance of all contractor insurance and pension reviews, including those associated with indemnification requests.²⁴ Specifically, DCMA's CIPR office has a team of insurance experts who conduct these reviews when the administrative contracting officer determines a review is needed.²⁵ CIPR officials told us that one of their functions is to work with contracting officers to review contractors' insurance coverage and provide insurance memorandums that support the indemnification request packages. CIPR officials stated they would expect DCMA to be involved in all or most indemnification request reviews, but acknowledged that there may be straightforward scenarios that do not require their expertise.

DCMA officials stated all of the CIPRs in recent years have been performed for the Air Force and MDA. The Air Force's Indemnification Guide states that contracting officers should use DCMA's insurance specialists during the indemnification request review process. MDA officials we spoke with told us they use DCMA as needed, based on their prior knowledge and experience. Air Force and MDA officials we spoke with who had used DCMA's CIPR function told us that it was useful to their review of indemnification request packages. MDA officials added this is because contracting officers do not generally have insurance expertise.

However, officials from the Navy and DLA said they do not use DCMA's CIPR office. Generally, Navy officials we spoke to said that while they were aware that DCMA assistance was available, they felt it was not needed for their annual nuclear indemnification process because the

²³According to DCMA, in some cases procurement contracting officers may also determine the need for and request a CIPR.

²⁴Defense Contract Management Agency, *Forward Pricing Rates*, DCMA Manual 2201-01 (April 14, 2021).

²⁵DFARS 242.73 Contractor Insurance/Pension Review

contractors' insurance information was usually consistent over time. However, Navy officials stated that not all of the Navy's indemnification requests are nuclear-related or reviewed during the annual cycle. Further, Navy program and procurement officials we spoke with acknowledged that they are not insurance experts and thus may not have a full understanding of contractors' insurance coverage when reviewing requests. Additionally, some DLA officials we spoke with were unaware of DCMA's insurance review function.

Across DOD, DPC is the office that executes statute, executive order, and policy and issues memorandums and guidance to empower the DOD contracting community with key resources. *Standards for Internal Control in the Federal Government* state that information should be communicated down, across, up, and around reporting lines to all levels of the entity.²⁶ Because some DOD components are unaware of—or not fully considering the use of—DCMA to assist in indemnification request reviews, they may be missing an opportunity to leverage existing insurance expertise during the review process.

Contractors Obtain Limited and Varied Coverage from Multiple Insurers Based on Overall Risk

Defense contractors use multiple insurers, from a limited market, to obtain aviation insurance coverage for their work.²⁷ Insurers develop a risk profile for each contractor to inform this coverage, based on their assessment of risk on a number of factors. World events, such as the COVID-19 pandemic and the conflict in Ukraine, also affect insurance coverage, especially as the aviation insurance market continues to shrink.

Defense Contractors Generally Use Multiple Insurers to Obtain Coverage

Defense contractors report that they generally need exceptionally high insurance coverages that no single insurer can provide. Instead, contractor representatives told us they use brokers to obtain coverage

²⁶GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

²⁷As previously noted, throughout this report we use the terms insurance, insurance coverage, insurance market, etc. to refer to aviation insurance.

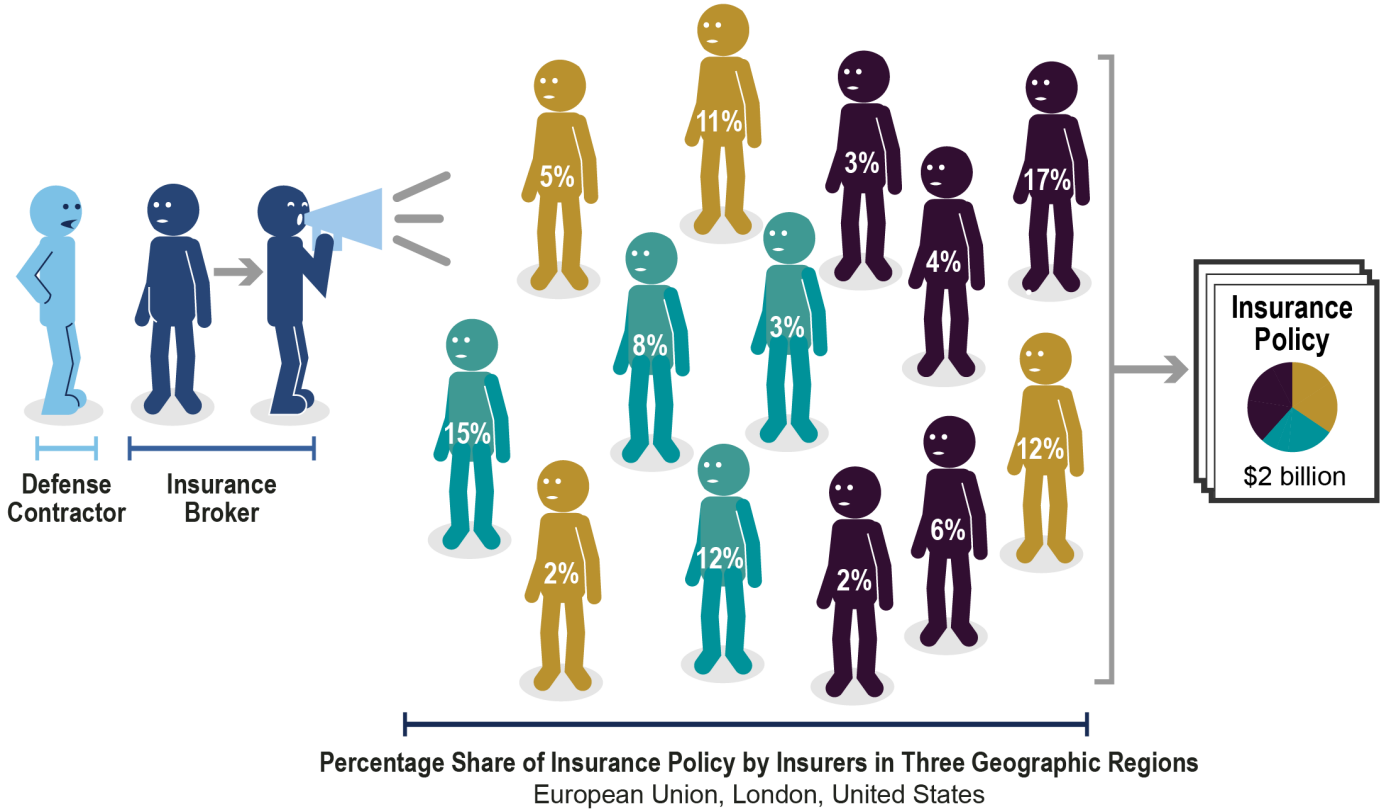
from multiple multi-national insurers, covering both their government and commercial work under a single policy.²⁸ This is known as a quota share arrangement.²⁹ These policies are then renewed on an annual basis. Insurance industry representatives told us that there are about 25 insurers from which brokers obtain coverage on behalf of defense contractors. These insurers are from three major geographic areas: the European Union, London, and the United States. These representatives told us they do not use available insurers from other geographic regions, such as China, due to security concerns. One defense contractor told us that more than half of its overall insurance coverage was provided by international insurers. Figure 2 shows the process of a contractor using a broker to create a policy with a quota share arrangement.

²⁸One major defense contractor we spoke with does not use brokers to obtain insurance coverage for its work and instead uses a captive insurance company. Captive insurers are special-purpose insurance companies set up by commercial businesses to self-insure risks arising from the owners' business activities.

²⁹Quota sharing is a process by which multiple insurers share in the same losses, dividing the risk among multiple carriers so that no single insurer bears the entire exposure.

Figure 2: Example Process by Which Defense Contractors Obtain Insurance Coverage Through a Broker in a Quota Share

Each figure represents a single insurer. Percentages for each insurer are notional and represent what each insurer contributes to the quota share.



Source: GAO analysis of aviation insurance industry and defense contractor information; GAO (icons). | GAO-24-106403

Accessible Text for Figure 2: Example Process by Which Defense Contractors Obtain Insurance Coverage Through a Broker in a Quota Share

Category	Level
Defense Contractor	One
Insurance Broker	Two
Percentage Share of Insurance Policy by Insurers in Three Geographic Regions (European Union, London, United States)	Three
Insurance Policy (two billion dollars)	Four

Sources: GAO analysis of aviation insurance industry, defense contractor information; GAO (icon). | GAO-24-106403

Insurers noted that this division of coverage into smaller amounts limits the amount of risk any one insurer incurs under the policy. An example quota share document we reviewed showed coverage percentages as low as 2 percent and as high as 17.5 percent. The insurance company

with the highest share of coverage on a policy acts as the lead insurer. The lead insurer's responsibilities can include outlining the terms and conditions of the insurance policy and adjusting claims. Other insurers within the quota share receive this information from the lead insurer and the insurance broker.

Insurance Companies Base Coverage Decisions on Contractor and Market Risk

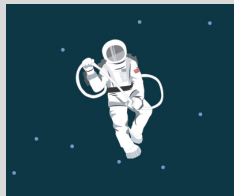
Insurers told us they consider a number of factors in developing a risk profile for defense contractors when determining how much coverage capacity they will provide. These factors include:

- **The contractor's loss history**—insurers use a contractor's historical insurance claims data to model the frequency and magnitude of future claims. Contractors with a history of more significant losses may pay more or receive less coverage.
- **The contractor's lines of business**—insurers examine the proportion of business a contractor does commercially and for the government. Insurers said they generally consider government business to be less risky as government contractors are shielded from liability in ways that non-contractors are not.
- **Contractor indemnification by the government**—insurers explained that they will generally not provide coverage for products that could involve unusually hazardous risks, except in limited circumstances. In order to do so, insurers told us they must consider: the information available about the product, the total value of the product, and use of the product in military actions. Insurers explained that coverage of unusually hazardous risks is limited or unavailable in instances where information about the risk is insufficient, a product is of an especially high value (for example, a single asset may be worth billions of dollars), or when a product is used as part of a hostile action. Therefore, whether the government provides indemnification is a key factor that insurers consider when determining if they might provide any amount of coverage.

We previously reported that insurers have historically used standard exclusions to exclude certain risks, such as nuclear risks, from their policies.³⁰ In instances where commercial insurance is not available,

³⁰GAO, *Terrorism Insurance: Status of Coverage Availability for Attacks Involving Nuclear, Biological, Chemical, or Radiological Weapons*, [GAO-09-39](#) (Washington, D.C.: December 2008).

contractor representatives explained, government indemnification is the only coverage available to defense contractors. Other risks, such as those associated with war or certain types of pollution, can also be excluded from policies, with some exceptions.³¹ Finally, insurance industry representatives explained that some work conducted by defense contractors is neither explicitly covered nor excluded. For example, while classified work is not explicitly excluded from policies, insurers told us they do not expect to cover classified work as they are unable to access the information needed to properly assess the risk or adjust a claim involving a classified program. Insurance industry representatives we spoke with explained that due to the multi-national nature of their business, they are generally not interested in seeking the necessary security clearances to examine classified programs. Insurance industry representatives further noted that a large loss or a series of large losses from a certain type of risk may lead to further policy exclusions in the future.



Indemnification and Insurance at NASA The limited nature of the aviation insurance market posed issues for contractors and the National Aeronautics and Space Administration (NASA) on the Space Launch System and Orion programs, according to contractor representatives. Specifically, all six of the prime contractors used the same insurers from a relatively small market. Insurers do not expect to pay full limits for multiple manufacturers on any single product, since in the case of a catastrophic incident, those insurers could be liable for billions of dollars in total liability. As such, the insurers initially wanted to withdraw coverage for the project.

To resolve this issue, NASA, contractor, and insurance industry personnel developed a single insurance policy that bundled the risk of all the contractors, with NASA listed as an additional insured party. NASA indemnified the remaining risk above the limits of the policy, enabling work to continue.

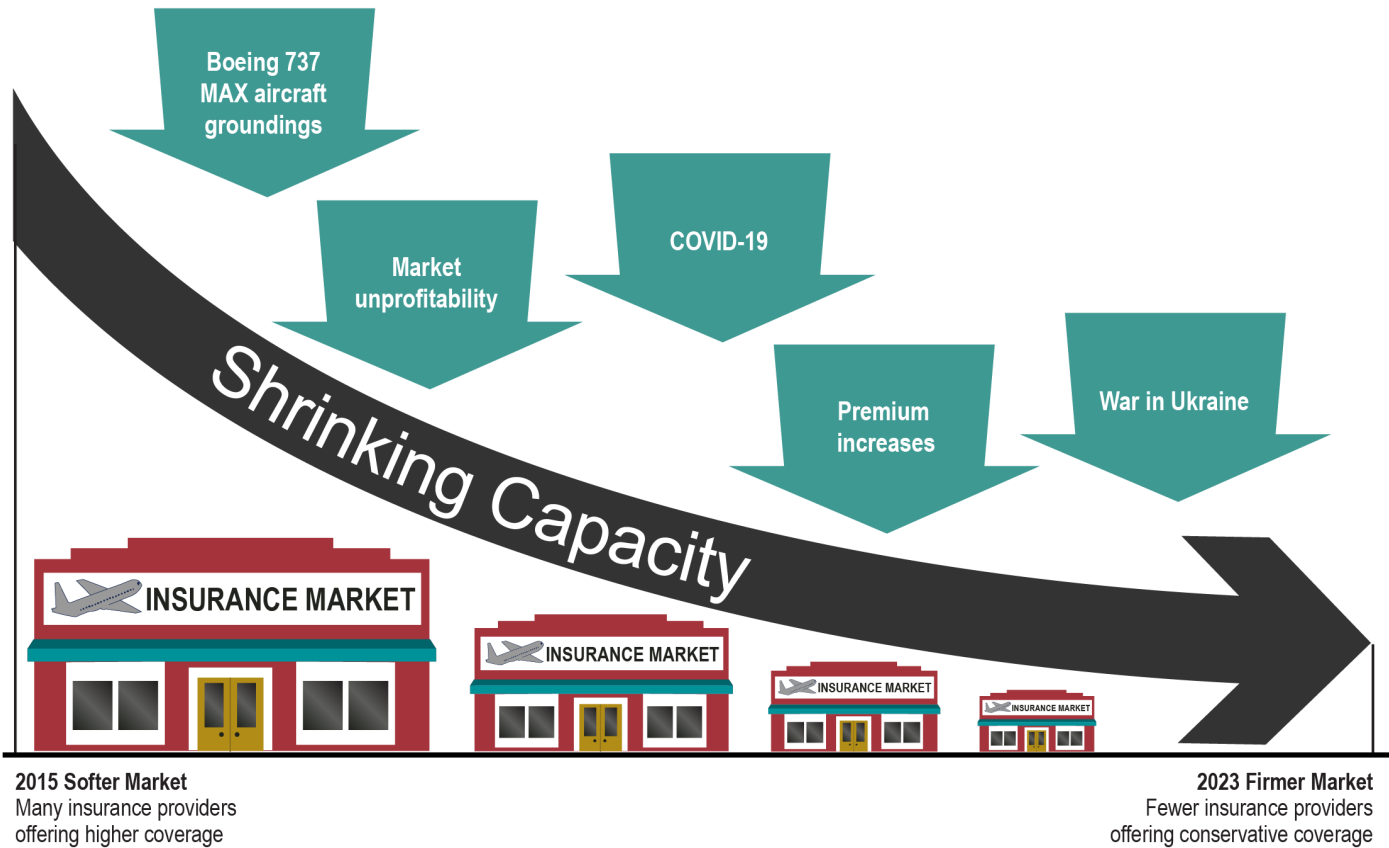
Source: GAO analysis of defense contractor information; GAO (icon). | GAO-24-106403

Insurance industry and contractor representatives explained that due to the limited number of insurers, the insurance market does not have the broad capability to absorb losses, and is subject to volatility in reaction to

³¹Insurance industry representatives noted that a common exclusion in aviation insurance policies states that, with some exceptions, a policy will not cover claims in relation to: (a) noise (vibration, sonic boom), (b) pollution and contamination of any kind, (c) electrical and electromagnetic interference, and (d) interference with the use of property. Defense contractors noted that they may be able to obtain very limited coverage for these risks through a policy write back, where a normally excluded risk is reinstated under an insurance policy for limited amounts and under specific circumstances.

world events. For example, they explained that years of losses among commercial airlines have impacted profitability in the aviation market, leading insurers to exit that market and fewer insurance companies to enter. Recent world events, including the groundings of Boeing’s 737 MAX aircraft, the COVID-19 pandemic, and the conflict in Ukraine, also limit overall market capacity, according to industry representatives. For example, contractor and insurance representatives said that the current conflict in Ukraine could cause aviation industry losses in excess of \$10 billion due to aircraft seizures by the Russian government. As a result, at least one insurer we spoke with no longer offers coverage for aircraft seizure. Figure 3 displays how recent world events have contributed to the shrinking of the aviation insurance market in terms of the number of insurers, capacity, and coverage limits.

Figure 3: Shrinking of the Aviation Insurance Market Due to Global Events and Market Forces, 2015-2023



Sources: GAO analysis of aviation insurance industry, defense contractor information; GAO (icon). | GAO-24-106403

Accessible Text for Figure 3: Shrinking of the Aviation Insurance Market Due to Global Events and Market Forces, 2015-2023

Shrinking capacity causes

Boeing 737 MAX aircraft groundings

Market unprofitability

COVID-19

Premium increases

War in Ukraine

Sources: GAO analysis of aviation insurance industry, defense contractor information; GAO (icon). | GAO-24-106403

As a result of this shrinking and reactive aviation insurance market, insurance industry officials told us that the terms and conditions of insurance policies for defense contractors have become more limited and coverage has become more restricted, while premiums have increased.

DOD Addressed Recent Indemnification Challenges and Maintains Flexibility to Address Future Risks

DOD experienced challenges negotiating recent contractor indemnification requests, but resolved concerns after prolonged negotiations that in one case may contribute to future program delays. Additionally, while there are some challenges associated with not defining unusually hazardous risk in regulation, DOD maintains flexibility to consider indemnification requests based on each component’s unique needs.

Resolution of Indemnification Challenges Required Prolonged Negotiations

Some DOD components have experienced challenges related to contractor indemnification requests for risks related to current requirements. Specifically:

- Beginning in 2021, the Navy experienced challenges related to two indemnification requests it received—one from a prime and subcontractor working on Conventional Prompt Strike (CPS) and one from a prime contractor and subcontractor working on the *Virginia-*

class submarine program.³² As of early 2023, these issues had been resolved.

- As of September 2023, DLA was experiencing challenges related to two indemnification requests related to spare parts contracts supporting multiple Navy requirements.

In December 2021 and June 2022, the Navy received requests to indemnify unusually hazardous risk related to (1) CPS and (2) Tomahawk and CPS missiles as carried on *Virginia*-class submarines.³³ In reviewing these requests, Navy officials told us they were concerned that the standard FAR and DFARS indemnification clauses did not hold contractors sufficiently accountable for potential malfeasance. In response, the Navy modified the standard FAR and DFARS indemnification clauses to provide greater contractor accountability for three of the four involved contractors. The clauses were incorporated into the contracts in early 2023. Table 5 below compares the levels of accountability prescribed in the FAR and DFARS as compared to the modifications enacted by the Navy.

Table 5: Contractor Accountability under Standard and Modified Indemnification Clauses and Programs Impacted

Regulation	Standard clause	Navy modification	Programs impacted
Federal Acquisition Regulation 52.250-1	Contractors will not be indemnified for government claims against the contractor or for losses or damages affecting the contractor's property, if the claim, loss, or damage is caused by, "...willful misconduct or lack of good faith on the part of any of the Contractor's principal officials" ^a	Contractors will not be indemnified for any claims, loss or damages caused by, "...willful misconduct, intentional fraud or lack of good faith on the part of the Contractor's principal officials or the Contractor's operating officials" ^b	Conventional Prompt Strike and Tomahawk missiles as carried on Virginia-class submarines

³²The CPS program aims to develop an intermediate-range hypersonic missile. The program expects to field CPS on *Virginia*-class submarines by 2030.

³³*Virginia*-class submarines are nuclear powered vessels that are indemnified under the Navy's annual nuclear indemnification process.

Letter

Regulation	Standard clause	Navy modification	Programs impacted
Defense Federal Acquisition Regulation Supplement 252.235-7000	Contractors will not be indemnified for any claims, losses, or damages that result from, "...willful misconduct or lack of good faith on the part of any of the Contractor's directors or officers, managers, superintendents, or other equivalent representatives who have supervision or direction of—(i) All or substantially all of the Contractor's business; (ii) All or substantially all of the Contractor's operations at any one plant or separate location where this contract is being performed; or (iii) A separate and complete major industrial operation connected with the performance of this contract."	Contractors will not be indemnified for any claims, losses, or damages that, "directly result from...fraud, willful misconduct, or lack of good faith on the part of any of the Contractor's or Subcontractor's employees at any other level." ^c	Conventional Prompt Strike

Source: GAO analysis of regulatory and Navy information. | GAO-24-106403

^aThe Federal Acquisition Regulation defines principal officials as, "...directors, officers, managers, superintendents, or other representatives supervising or directing: 1) All or substantially all of the Contractor's business, 2) All or substantially all of the Contractor's operations at any one plant or separate location in which the contract is being performed; or 3) A separate and complete major industrial operation in connection with the performance of the contract."

^bThe Navy defined operating officials based on "responsibilities for oversight, review, and sign off on the completion of work" for functions including nuclear-powered submarine new construction, quality or process excellence, and engineering and/or design efforts associated with nuclear-powered submarine new construction, among others.

^cThis modification was made in addition to the standard indemnification clause, rather than as a replacement.

Navy officials told us that they would consider using the modified clauses on future contracts on a case-by-case basis.

Officials from other components that received indemnification requests did not share the Navy's concerns about the level of accountability provided by the standard indemnification clauses. Air Force legal officials told us that excluding losses stemming from willful misconduct of contractor employees at a more junior level than identified in the FAR and DFARS could undermine the purpose for which indemnification is being extended in the first place. They told us this is because excluding such losses fails to protect contractors against catastrophic losses that if fully born by the contractor could have deleterious consequences for national security.

Additionally, in one case related to the indemnification request for Tomahawk and CPS missiles as carried on *Virginia*-class submarines, the Navy was unable to use the modified clause. Accordingly, the Navy and the contractor agreed to an alternative arrangement similar to an insurance policy with a deductible. Unlike under the modified clauses, in this case the Navy agreed to indemnify the contractor in instances where the contractor lacks aviation insurance that fully responds to the loss for claims resulting from willful misconduct, intentional fraud, or lack of good faith on the part of the contractor's operating officials. In such cases, the

contractor agreed to pay the first \$1 million of losses and damages for each occurrence, the Navy would pay any amounts up to \$1 billion, and the contractor would pay for any amounts above \$1 billion. This unique arrangement excluded indemnification claims arising from the willful misconduct, intentional fraud, or lack of good faith by the contractor's principal officials.³⁴

Navy and contractor officials told us that in the case of both indemnification requests, negotiations were prolonged. Navy officials indicated, however, that the prolonged negotiations did not contribute to schedule delays on CPS. Contractor representatives explained this is because they were able to execute work that was not considered unusually hazardous while the negotiations were ongoing. However, contractor officials working on the *Virginia*-class program told us they declined to make purchase orders for long-lead items while negotiations were ongoing. Because the *Virginia*-class program was already behind schedule at the time of the negotiations, officials could not estimate the exact schedule effects of these prolonged negotiations.³⁵ Navy officials told us they worked with suppliers to mitigate potential schedule effects, but that the prolonged negotiations may contribute to future program delays.

In another example, DPC officials told us that as of September 2023, DLA was experiencing challenges related to two indemnification requests for spare parts contracts, one supporting *Virginia*-class components and a second supporting other Navy requirements for nuclear vessels. Because the spare parts contracts would support Navy programs with indemnification requests that had already been approved under the Navy's annual indemnification process, DLA officials initially worked with the Navy to determine whether the Navy could grant an indemnification request related to the spare parts contracts under that process. However, the Navy's process did not cover DLA's spare parts procurements,

³⁴Principal officials are identified in the FAR as "...directors, officers, managers, superintendents, or other representatives supervising or directing: 1) All or substantially all of the Contractor's business, 2) All or substantially all of the Contractor's operations at any one plant or separate location in which the contract is being performed; or 3) A separate and complete major industrial operation in connection with the performance of the contract." In contrast, operating officials were defined by the Navy based on "responsibilities for oversight, review, and sign off on the completion of work" for functions including nuclear-powered submarine new construction, quality or process excellence, and engineering and/or design effort associated with nuclear-powered submarine new construction, among others.

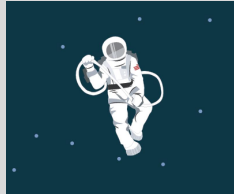
³⁵As of June 2023, the *Virginia*-class program office stated it was not meeting a two-ship-per-year construction rate and that each ship in the program's current block would take an average of 2 years longer to produce than previously reported.

because the approval authorities outlined in the FAR and DFARS do not allow the Navy to grant indemnification requests for another component's contracts. Instead, as previously noted, OUSD(A&S) must approve certain indemnification requests on behalf of DLA. As of September 2023, OUSD legal officials had returned one request to DLA for revision to meet regulatory requirements. With respect to the second request, DLA, OUSD(A&S), and Navy officials have been working together to resolve issues, but have been unable to reach consensus about the specific unusually hazardous risk to which the contractor providing the spare parts would be exposed. As a result, DLA now considers some of the parts concerned "non-procurable." When asked, however, Navy officials could not provide us with examples of adverse impacts to any Navy programs.

DOD Maintains Flexibility in Determining Unusually Hazardous Risk as Risks Evolve

The authorities governing the use of indemnification give DOD components flexibility to assess unusually hazardous risk on a case-by-case basis. Public Law 85-804, title 10 section 3861 of the U.S. Code, and the associated FAR and DFARS provisions do not explicitly define the term unusually hazardous risk. In the National Defense Authorization Act for Fiscal Year 2022, Congress put forth a definition of unusually hazardous risk, but only for the reporting purposes outlined in that statute.³⁶ The statute defines unusually hazardous risk as the risk of burning, explosion, detonation, flight or surface impact, or toxic or hazardous materials release that is associated with certain types of programs. These programs include hypersonic weapons, rocket propulsion systems, and classified programs for which no insurance is available for certain reasons related to classification. However, DOD components are not required by statute or regulation to use that definition when evaluating indemnification requests.

³⁶See National Defense Authorization Act for Fiscal Year 2022, Pub. L. No. 117-81, § 1684(d)(5) (2021).



Indemnification Coverage at NASA

To facilitate the indemnification of NASA's Space Launch System and Orion spacecraft, and after collaboration between industry, technical, and program legal and contracting officials, NASA internally defined unusually hazardous risk. The definition includes the specific periods of the mission where indemnification is applicable and inapplicable, and outlined the particular risks and scenarios that would be indemnified. These include but are not limited to: risks specific to the use of energized propellants, and risks associated with surface or in-flight impacts between Space Launch System or Orion components and government, or third-party, property.

Source: GAO analysis of National Aeronautics and Space Administration (NASA) information; GAO (icon). | GAO-24-106403

The components we spoke to varied in how they assessed unusually hazardous risk. For example:

- Navy officials told us that they are now considering the definition from the National Defense Authorization Act for Fiscal Year 2022 of unusually hazardous risk when evaluating indemnification requests, even though they are not required to do so.
- The Air Force provides an example definition of unusually hazardous risk in its Indemnification Guide, which outlines unusually hazardous risk factors associated with space launch vehicles.
- Other components we spoke with did not have definitions of unusually hazardous risk.

Contractor representatives cited concerns about whether DOD would indemnify risks associated with emerging technologies, cybersecurity risks, environmental hazards, and classified work for future requirements in the absence of a clear definition in regulation. For example, contractor representatives were especially concerned that as DOD has increased its use of fixed-price contracts in recent years, contractors are generally bearing more risk than under cost-reimbursement type contracts. Contractor representatives told us this is particularly the case for classified work, which is often uninsurable. Contractor representatives expressed that because there is no requirement to do so, DOD may not consider lack of insurance availability when determining whether to indemnify a classified contract. Contractors explained that they have recently experienced challenges related to such work. However, since most DOD components we selected could not provide information on their classified indemnification requests, the total scope of such challenges is unclear.

DPC officials explained that defining unusually hazardous risk also carries its own challenges. Notably, if unusually hazardous risk is defined too narrowly, it may inadvertently exclude risks that should be indemnified. Officials also explained that the flexibility afforded to the components to define unusually hazardous risk on a case-by-case basis allows each component to consider the risks that may be unique to their mission profiles. Finally, they noted that this flexibility is important due to the nature of emerging technologies.

Conclusions

Indemnification is a key tool that serves DOD and defense contractors by ensuring DOD can support the national defense and contractors can complete vital work in the face of potentially catastrophic financial risk. Further, as contractor and insurance industry representatives have reported, insurance coverage availability has decreased in recent years due to major losses in the aviation insurance market, the role that government indemnification plays in this process has become more important.

While DOD components maintain flexibility to define unusually hazardous risk on a case-by-case basis that is tailored to each component's unique mission profile, there is room for improvement in how indemnification requests are evaluated. Contracting officials and decision-makers may not have extensive expertise or knowledge of the insurance market and coverage available to defense contractors. However, DOD has resources at its disposal, such as DCMA's CIPR team, that could provide such expertise during indemnification request evaluations. Without consistent knowledge and full consideration of the use those resources across DOD's components, contracting officials at DOD are missing an opportunity to leverage valuable insurance expertise.

Recommendation for Executive Action

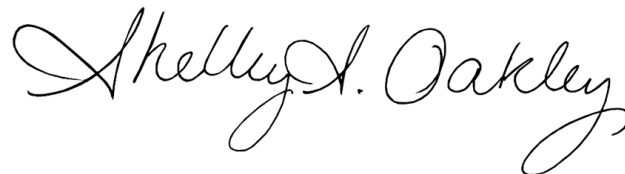
The Secretary of Defense should ensure the Principal Director of Defense Pricing and Contracting encourages contracting officials to consider the use of DCMA insurance reviews performed by its Contractor Insurance/Pension Review group when evaluating indemnification requests. (Recommendation 1)

Agency Comments

We provided a draft of this report to the Department of Defense for review and comment. In DOD's comments, reproduced in appendix I, it concurred with our recommendation and identified steps it planned to take to address the recommendation. DOD and NASA also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, the Administrator of the National Aeronautics and Space Administration, and other interested parties. In addition, the report is available at no charge on the GAO website at <https://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4841. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. Staff members making key contributions to this report are listed in appendix II.



Shelby S. Oakley
Director, Contracting and National Security Acquisitions

List of Addressees

The Honorable Jack Reed
Chairman
The Honorable Roger Wicker
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Jon Tester
Chair
The Honorable Susan M. Collins
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Mike Rogers
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable Ken Calvert
Chairman
The Honorable Betty McCollum
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Comments from the Department of Defense

Appendix I: Comments from the Department of Defense



ACQUISITION
AND SUSTAINMENT

OFFICE OF THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-3000

Ms. Shelby Oakley
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Washington DC 20548

Dear Ms. Oakley,

This is the Department of Defense (DoD) response to the GAO Draft Report GAO-24-106403, "DEFENSE CONTRACTING: DOD SHOULD ENCOURAGE GREATER USE OF EXISTING EXPERTISE TO REVIEW INDEMNIFICATION REQUEST," dated January 17, 2024 (GAO Code 106403).

Enclosed is the DoD's response to the subject report. My point of contact is Ms. Sara Van Gorder who can be reached at osd.pentagon.ousd-a-s.mbx.asda-dp-c-contractpolicy@mail.mil.

Sincerely,

TENAGLIA, Digitally signed by
JOHN.M.11 TENAGLIA.JOHN.M
54945926 .1154945926
Date: 2024.02.20
16:12:43 -05'00'

John M. Tenaglia
Principal Director,
Defense Pricing and Contracting

Enclosure:
As stated

Enclosure

**GAO DRAFT REPORT DATED JANUARY 17, 2024
GAO-24-106403 (GAO CODE 106403)**

**“DEFENSE CONTRACTING: DOD SHOULD ENCOURAGE GREATER USE OF
EXISTING EXPERTISE TO REVIEW INDEMNIFICATION REQUEST”**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION**

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense should ensure the Principal Director for Defense Pricing and Contracting (DPC) encourages contracting officials to consider the use of Defense Contract Management Agency (DCMA) insurance reviews performed by its Contractor Insurance Pension Review group when evaluating indemnification requests.

DoD RESPONSE: Concur. DPC will publish a policy memorandum encouraging the acquisition workforce to consider the use of DCMA’s Contractor Insurance Pension Review group when evaluating indemnification requests.

Accessible Text for Appendix I: Comments from the Department of Defense

Ms. Shelby Oakley
Director, Contracting and National Security Acquisitions
U.S. Government Accountability Office
441 G Street, NW
Washington DC 20548

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Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Shelby S. Oakley, (202) 512-4841 or oakleys@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following staff members made key contributions to this report: Julie A. Clark, Assistant Director; Sarah Tempel, Analyst-in-Charge; Pete Anderson; Vinayak Balasubramanian; Eviana Barnes; Sadaf Dastan; Lorraine Ettaro; Lijia Guo; Kurt Gurka; Tonya Humiston; Natalie Logan; Sophia Payind; and Maura Sullivan.

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