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WORKING PAPER

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LEGAL COMMITTEE – 33RD SESSION

(Montréal, 21 April – 2 May 2008)

Agenda Item 3: Compensation for damage caused by aircraft to third parties arising from acts of unlawful interference or from general risks

DRAFT CONVENTION ON COMPENSATION FOR DAMAGE CAUSED BY AIRCRAFT TO THIRD PARTIES, IN CASE OF UNLAWFUL INTERFERENCE

WORK OF THE SUPPLEMENTARY COMPENSATION MECHANISM (SCM) TASK FORCE – A SCM FUNDING MODEL

(Presented by the Supplementary Compensation Mechanism Task Force)

1. As noted in LC/33-WP/3-8 and LC/33-WP/3-11, following the example of the negotiations on the Cape Town Convention, the Supplementary Compensation Mechanism (SCM) Task Force was created at the fifth meeting of the SG-MR[1]**.** The Task Force was set up to develop drafts of the documents making up the secondary regulatory level under the Convention. The work of the Task Force has been carried out informally, its membership is open-ended and it decided its own Terms of Reference.

2. The Task Force has developed draft documents in relation to three items listed in the Terms of Reference and an outline of the likely content of a fourth document. The three draft documents are annexed to LC/33-WP/3-8. The fourth document that exists in outline only is appended to LC/33-WP/3-11 and will need to be considered further in the light of discussions at and decisions taken by the Legal Committee.

3. The secondary regulatory level will have to be agreed at the first Conference of the Parties following entry into force of the Convention. As was the case with the Cape Town Convention, it can be anticipated that a preparatory commission would be established to facilitate entry into force of the Convention and what needs to be in place at that point in time. Such preparatory commission would finalise the draft documents making up the second regulatory level.

4. In addition to the above, the Task Force would like to share a model (discussed during the SG-MR meetings) as further refined by one of its working groups to provide an idea of how the total amount of contributions to be collected for the SCM (after the Convention and the SCM come into force) can be arrived at from year to year taking into account the growing number of State Parties with their passenger and cargo traffic. This model contemplates that the maximum pre-funding limit for the SCM following widespread ratification will be SDR 3 billion[2]**.** It also deals with how contributions from States

[1] See paragraphs 1.111 and 1.113 of the Report on the Fifth Meeting of the Special Group

[2] Ref.: **Article 19(2)** of the Draft Convention on Compensation for Damaged Caused By Aircraft to Third Parties in case of Unlawful Interference Convention ("Convention").

joining at different times (including after the occurrence of an event) can be incorporated into the SCM funding system. Further, it also deals with the aspect of ensuring that initial contributions in respect of each Contracting State are the same regardless of when a State joins so that no State can be considered disadvantaged by joining earlier.

5. The SCM Task Force hopes that this model will assist the Committee in its consideration of the proposed SCM and the Convention.

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APPENDIX

A WORKING MODEL OF THE SUPPLEMENTARY COMPENSATION MECHANISM (SCM)

A Working group of the SGMR has proposed a working model to show how the total amount of contributions to be collected for the SCM (after the Convention and the SCM come into force) can be arrived at from year to year taking into account the growing number of States Parties with their passenger and cargo traffic. This model contemplates that the maximum pre-funding limit for the SCM following widespread ratification will be SDR 3 billion[1]**.** It also deals with how contributions from States joining at different times (including after the occurrence of an event) can be incorporated into the SCM funding system. Further, it also deals with the aspect of ensuring that initial contributions in respect of each Contracting State are the same regardless of when a State joins so that no State can be considered disadvantaged by joining earlier.

It is a straightforward model and contains not only pre-event[2] but also post-event funding elements.

The proposed model works as set out below, with 2010 as the first SCM year for ease of explanation.

1. ESTABLISHMENT OF THE SCM ANNUAL FUND LIMIT

1.1 This model proposes that once the Convention (and thus also the SCM) comes into force, a <u>separate Fund</u> is established for <u>each calendar year</u>.

1.2 Each separate Fund is <u>closed</u> if no catastrophic event likely to give rise to claims against it occurs in its first year but <u>continues</u> if such an event does occur until all claims against it and all expenses incurred are paid and all its recoveries are completed. The reason for providing for such <u>Fund closure</u> (if there is no event during the year) <u>and Fund continuity</u> (if there is) is for easy identification as to which contributions received from the Contracting States are to be allocated towards payment of victim compensation arising from an event and to enable the SCM to function as efficiently as possible.

1.3 The SCM Director will set a SCM Fund Limit for each calendar year. The Director determines this limit annually by collating the projected annual number of international and/or domestic (if opted in) passengers and tonnes of cargo of[3] States Parties. This information will be provided by the States Parties by a deadline set by the Director.

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[1] Ref.: **Article 19 (2)** of the Convention.

[2] "Event" means an event where damage is caused by an aircraft in flight as a result of an act of unlawful interference. (Ref: **Article 1(c)**).

[3] A policy decision is to be made on whether the contributions should be obtained / derived from passengers and shippers of cargo / freight carried on all aircraft <u>departing from</u> a State Party (i.e. regardless of carrier's nationality) or only from carriers <u>of</u> a State Party. [Ref.: **Article 12** of the Convention.]

1.4 The SCM Director then multiplies the total projected annual number of passengers at a base rate of SDR 2 per passenger and the total projected annual tonnes of cargo at a base rate of SDR 20 per tonne of cargo[4] to arrive at the SCM Fund Limit. At these rates, every 100 million of projected passengers equates to SDR 200 million for the SCM Fund Limit and every 1 million tonnes of projected cargo equates to SDR 20 million for the SCM Fund Limit.

1.5 Therefore,

a) if the States Parties report a total projection of **500 million** annual passengers and **10 million tonnes** of cargo, the SCM Fund limit will comprise **SDR 1 billion (from passengers) plus SDR 200 million (from cargo)** for a **total of SDR 1.2 billion SCM Fund Limit**;

b) the States Parties report a total projection of **1 billion** annual passengers and **15 million tonnes** of cargo, the SCM Fund limit will comprise **SDR 2 billion (from passengers) plus SDR 300 million (from cargo)** for a **total SDR 2.3 billion SCM Fund Limit**; and

c) if the States Parties report a total projection of **1.3 billion** annual passengers and **20 million tonnes** of cargo, the SCM Fund limit comprise **SDR 2.6 billion (from passengers) plus SDR 400 million (from cargo)** for a **total SDR 3 billion.**

1.6 This Model contemplates the following :

a) the **"normal" full Funding Period** for collecting contributions up to the full SCM Fund limit (when needed) is 4 years including the year of commencement of each SCM Fund;

b) the **Pre-event Funding amount** will be either 25% or 100%[5] of the SCM Fund Limit:

– if 25% pre-event Funding is selected, contributions will be collected only during the first year at **SDR 0.50 per passenger** (being 25% of the SDR 2.00 passenger base rate) and **SDR 5 per tonne of cargo** (being 25% of the SDR 20.00 cargo base rate); and

– if 100% pre-event Funding is selected, contributions at the foregoing base rates will be collected for a period of four years (including the first year).

c) the **Post-event Funding Period** can be reduced as needed:

– if the compensation required is not assessed as likely to extend to the full SCM Fund Limit; or

– if the compensation required is assessed as likely to extend to the full SCM Limit and early payments need to be made, by accelerating the contribution / collection period based on increasing the per passenger and per tonne of cargo contribution.

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[4] **The amounts of SDR 2 per passenger and SDR 20 per tonne of cargo used here are for the purpose of illustration in this model only.**

[5] Ref: **Article 15(2)** of the Convention.

d) the **Maximum Contribution**[6] amounts per passenger and per tonne of cargo in any two year period shall not exceed SDR 3 per passenger (per year) and SDR 30 per tonne of cargo (per year);

e) SDR 3 billion will be the maximum SCM Fund limit applicable to any one event;

f) Passenger numbers and cargo tonnage shall be projected on the basis of origin to final destination (excluding transit stops) so that passengers and cargo shippers are not double charged and to avoid distortion of competition.

1.7 Any reference to States Parties / air carriers being required to pay contributions in this model is to be understood as referring to contributions being obtained / derived through the States Parties / air carriers from the ultimate primary users of the commercial air transport system.

2. EXAMPLE: USING ONLY PASSENGER NUMBERS AND BASED ON 25% PRE-EVENT FUNDING

2.1 SCM First Year (2010) - SCM 2010 Fund established and no event occurs:

a) based on the foregoing, if the total number of passengers projected for the first year[7] of the Convention starting in 2010 is 500 million, then the SCM 2010 Fund Limit will be SDR 1 billion aggregate. The Pre-event Funding amount will be SDR 250 million to be collected at a contribution of SDR 0.50 per international and/or domestic passenger *of* States Parties in the first year; and

b) if at the end of the first year, no event has occurred that is likely to give rise to claims against the SCM, then the SCM 2010 Fund is closed off and a new SCM 2011 Fund established for the following calendar year. For the purposes of this example, we will assume that during the first year each 2010 State Party had physically transferred 75% (SDR 187.5 million) of its actual passenger contributions into the SCM 2010 Fund, via the IATA Clearing House or other agreed method. These funds will be automatically transferred by the Director into the SCM 2011 Fund for the respective individual accounts of these States Parties.

2.2 SCM Second Year (2011) - SCM 2011 Fund established & new States join at beginning of the year:

a) if the total number of passengers projected for the second year (2011) is 600 million, then the SCM 2011 Fund Limit will be SDR 1.2 billion aggregate, the 25% Pre-event Funding amount will be SDR 300 million to be collected at a per passenger contribution of SDR 0.50;

b) we will assume that these 600 million passengers are made up of 550 million passengers from the 2010 States Parties and 50 million from ‘new’ 2011 States Parties (i.e. those who have newly ratified and for whom the Convention came into force at the start of the new calendar year (2011));

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[6] Ref: **Article 13** of the Convention.

[7] It is possible that the coming into force of the Convention and the SCM could take place in the middle of a year. However, for the purpose of this model, it is assumed that the SCM commences on 1 January 2010, making the first SCM year a full calendar year.

c) based on these projections and assumptions, the Pre-event Funding contributions for the SCM 2011 Fund from the 'old' 2010 States Parties would be SDR 275 million (550 million x SDR 0.50 per passenger). As these 'old' 2010 States Parties already have SDR 187.5 million on account from 2010, this just leaves them a combined balance of SDR 87.5 million to be collected over the course of the year (2011) to fulfil their (individual) Pre-event Funding obligations. The Pre-event Funding contributions of the 'new' 2011 States Parties would be SDR 25 million (50 million x SDR 0.50 per passenger) to be collected over the course of the year; and

d) in this way, every State Party contributes the same and no State enjoys a greater advantage by joining mid term.

2.3 **SCM Second Year (2011) – new States join mid-term when no event has occurred:**

a) a New State Party (NSP) would automatically join the SCM when the Convention comes into force for it. If its joining occurs part way during the course of any year, then the NSP's Pre-event Funding contributions will be calculated at pro rata; and

b) for example, if a NSP with 50 million annual passengers joins exactly half way through 2011, then its Pre-event Funding contributions for the remainder of 2011 will total SDR 12.5 million (50 million x 50% x SDR 0.50) and the total SCM 2011 Fund Pre-event Funding amount will increase from SDR 300 million to SDR 312.5 million.

2.4 **SCM Second Year (2011) – event occurs after 7 months:**

a) if an event occurs 7 months into 2011, the SCM Director and/or the Conference of Parties will make an assessment as to :

   i) the likelihood that total claims will exceed the strict liability limits of the Convention and thus the estimated total consequent exposure of the SCM 2011 Fund, and/or
   ii) whether the Fund is required to drop down[8] (to provide financial support for the air carrier concerned) because of no or limited insurance cover, and
   iii) whether the contributions need to be increased above SDR 0.50 per passenger to accelerate payments into the SCM 2011 Fund to provide for possible early settlement of claims;

b) if the event is assessed as likely to result in claims against the SCM 2011 Fund, then the NSP's maximum contributions will be SDR 87.5 million (5 months at 25 million passengers plus 3 full years at 50 million passengers x SDR 0.50), and the revised SCM 2011 Fund Limit will be SDR 1,287,500,000;

[8] Please note that **Article 19(3)** of the Convention stipulates as follows:

"3. If insurance in respect of the damage covered by the Convention, or for part of these risks, is unavailable with respect to the amounts of coverage or the risks covered, or is only available at a cost incompatible with the continued operation of air transport, the Conference of Parties may decide that the Supplementary Compensation Mechanism shall in respect of future events causing damage compensable under this Convention, provide financial support to operators for the payment of damages for which they are liable according to Articles 3 and 4. The Conference of Parties may decide on a fee, the payment of which, for the period covered, shall be a condition for access to the protection given by such decision. "

c) if the assessment results in the decision to continue to build the full SCM 2011 Fund and to keep the contributions at the SDR 0.50 per passenger level, then the 2011 States Parties, including mid-term additions, will be required to continue with their SCM 2011 Fund contributions for the next 3 years and 5 months (to make a total contribution / collection period of 4 years);

d) if the assessment results in the decision to continue to build the full SCM 2011 Fund and to increase contributions to the Maximum Per Passenger Contribution of SDR 1.00 only from the expiry of 12 months from the commencement of the SCM 2011 Fund, then all the 2011 States Parties will be required to continue with their 2011 contributions for 5 months at the initial rate of SDR 0.50 per passenger and for 18 months at the increased rate of SDR 1.00 per passenger, thus making a total contribution / collection period of 2 years and 6 months [12 months at initial per passenger contribution and 18 months (instead of 36 months) at increased per passenger contribution]; and

e) during the collection period, it may become apparent that it is only necessary to collect part of the balance of the 2011 SCM Fund Limit to cover all claims and expenses. Once this collection level has been achieved and all claims and expenses have been settled and any recoveries made, then the SCM 2011 Fund can be closed off. Any funds left over can be transferred to the 2012 SCM Fund for the account of the 2011 States Parties and this will be in proportion to the annual or pro rata contributions made.

2.5 **SCM Second Year (2011) - Drop down required:**

a) if the 2011 Fund is required to drop down due to the *fault or neglect*[9] by an air carrier to maintain readily available insurance to cover its full Strict Liability obligations, then the SCM Director and/or Conference of Parties (COP) will have the option of increasing the SCM 2011 Fund Limit by the amount of the drop down required to satisfy the full Strict Liability limit applicable to the event (e.g. SDR 500 million). In such case, the Director and/or COP may increase the passenger contribution by up to a further USD 0.50 per passenger, in addition to the maximum per passenger contribution, to allow the additional funds to be collected in a timely fashion;

b) the above option will not be necessary if the SCM 2011 Fund is deemed sufficient to cover all claims from the event without additional funds and no further losses occur in the first 12 months;

c) the air carrier who is *at fault or has neglected* shall be required to reimburse the SCM for the drop down amount at a contribution of SDR 1.00 per passenger carried in addition to its other SCM current and future contribution obligations;

d) the Fund will drop down for non-insurable risks (e.g. nuclear or radioactive perils) and the SCM Fund Limit will be the total limit that applies to non-insurable risks; and

[9] Please note that presently, no policy decision has been made as to whether the drop down envisaged in **Article 15(3)** of the Convention will extend to the case when the insurance unavailability is due to the *fault or neglect* of the air carrier concerned. The present inclusion of this drop down possibility in this Model is for the purpose of consideration and to assist in the policy decision-making.

e) *[If there is war risk insurance market failure, States Parties may have to immediately arrange government guarantees or other arrangements (e.g. activation of the establishment of Globaltime*[10]*) to cover the Strict Liability obligations under the Convention.]*

2.6 **SCM Second Year (2011) – another new State joins after an event has occurred and further event occurs:**

a) if a NSP with 50 million annual passengers joins the SCM after an event has occurred in 2011, then *its* international (and, if it has opted in, domestic) passengers will only be required to make pro rata Pre-event Funding contributions at the SDR 0.50 contribution for the remainder of 2011. They will not be required to contribute Post-event Funding amounts for the event that has occurred; and

b) however, if a further event occurs during 2011 that is likely to result in further claims against the SCM, then passengers *of* the NSP will be required to contribute in addition to the Pre-Funding contributions, Post-event Funding contributions of up to SDR 75 million (50 million passenger x 3 years x SDR 0.50). The SCM 2011 Fund Limit shall be adjusted accordingly to take these additional contributions into account.

2.7 **SCM Third Year (2012) – SCM 2012 Fund established & SCM 2011 Fund continues:**

a) if the total number of passengers projected for the SCM 2012 Fund is 750 million, then the SCM 2012 Fund Limit will be SDR.1.5 billion aggregate, the Pre-event Funding amount will be SDR 375 million to be collected at a contribution of SDR 0.50 per passenger;

b) **for those States Parties participating in both the SCM 2011 and 2012 Funds, the 2012 contributions will be in addition to the contributions being collected for the on-going SCM 2011 Fund;**

c) if at the end of the 2012 year, no event has occurred that is likely to give rise to claims against the SCM 2012 Fund, then the SCM 2012 Fund is closed off and the contributions collected are transferred into the SCM 2013 Fund; and

d) if an event does occur, then further contributions to the SCM 2012 Fund will be required as explained for the SCM 2011 Fund.

3. 100% PRE-EVENT FUNDING

3.1 If 100% Pre-event Funding is to apply, then the passengers and cargo shippers of each State Party will be required to pay the base rates of contribution for a period of four years from the date the Convention enters into force for each State Party.

[10] Globaltime is currently held in contingency mode. Please refer to ICAO Assembly Working Paper A35-17 dated 18 Jun 2004 and ICAO Assembly (35th Session) Report on Agenda Item 35.

4. STATES PARTIES WHO DENOUNCE THE CONVENTION

4.1 A State Party who wishes to denounce the Convention may do so subject to giving 12 months' notice from the start of the next Fund year.

4.2 During the notice period, that State Party's passengers shall continue to contribute Pre-event Funding contributions and if an event occurs during the notice period that is likely to give rise to claims against the SCM, the State Party's passengers shall be required to make all Post-event Funding contributions for the SCM Funds to which that State is party.

4.3 Any such State Party shall be entitled to receive its share of any surplus funds or recoveries from the Funds established during the years in which it is State Party which are eventually closed off.

5. INSURANCE/REINSURANCE

5.1 It is proposed that the SCM Director and/or Conference of Parties shall be authorised to use the contributions in the SCM Funds to purchase, if available at reasonable cost, insurance or reinsurance cover from the commercial markets in order to protect the SCM Funds or to increase the size of the Funds or to insure against fault or neglect to purchase primary insurance.

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