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CONVENTION ON COMPENSATION FOR DAMAGE TO THIRD PARTIES, RESULTING FROM ACTS OF UNLAWFUL INTERFERENCE INVOLVING AIRCRAFT (UNLAWFUL INTERFERENCE CONVENTION)

(Presented by International Air Transport Association (IATA), International Union of Aerospace Insurers (IUAI), London & International Insurance Brokers' Association (LIIBA), Civil Air Navigation Services Organisation (CANSO), Airports Council International (ACI), Aviation Working Group (AWG))

1. BACKGROUND

The Joint Industry Group would like to take this opportunity to address certain concerns which have been raised by Member States with regard to the breakability of the limits on the operator's liability and the exoneration of other industry entities.

2. CAP ON OPERATORS' LIABILITY

2.1 It has been stated that the operator does not have to pay any compensation in most cases in which it contributed to the damage by fault because in the first tier its insurance will step in. The flaw in the logic of this argument is the misstatement that because insurers pay the damages in the first tier, the operator itself does not pay. However, there is no insurance without payment of premiums by the operator.

The insurance funds in the first tier are the combined premiums of the airlines, aircraft operators, manufacturers, lessors, financiers and service providers who purchase war, terrorism and other perils' insurance on an annual basis.

In the year following the terrorist attacks of 9/11 the commercial airline premiums alone increased by UDS 2.5 billion. In addition, many airlines were also charged for government guarantees that supplemented or replaced commercial coverage.

The argument that payment by the insurer is not effectively payment by the operator further collides with a fundamental principle of insurance and commerce. If the prudent businessman - or even car driver - cannot protect himself by buying insurance against the risk of a mistake by himself or an employee, what is the purpose of insurance?

Businesses, aviation or otherwise, have to purchase insurance as a necessity, both to meet legislative and regulatory requirements and to cover their perceived exposures arising from the course of their operations. The breadth and depth of operating exposures, both mandated and perceived, make it impossible for businesses to carry sufficient reserves to cover these exposures: without insurance businesses could not exist; airlines could not operate.

The proposition that an operator does not have to pay because its insurers will would come as a surprise to every car owner in the world who buys insurance against damage caused by his negligence, since that is precisely the protection for which he pays his premiums. In most States third party liability insurance for car drivers is mandatory. The idea that it is at no cost to the driver, and that if he negligently causes injury he should provide compensation from his own assets as a punishment and an encouragement to him to raise his driving standards would be unacceptable. It is similarly unacceptable that the operator's insurance protection should be nullified and that instead its assets should be sequestered for the purposes of compensation: this amounts to confiscation from the operator's shareholders which is an approach that is unconstitutional in many States.

The method chosen to punish negligent car drivers adopted by States is to have recourse to the criminal law, not to muddle punishment with civil law remedies for negligent injury. This remains the appropriate method to monitor standards. Regulators are able to withdraw the driver's or operator's licence to operate if the fault is sufficiently gross.

The opposing argument starts from the incorrect premise that the purpose of the Convention is to punish the operator by confiscating its assets in the event of an accident. This gives the terrorist the opportunity further to enhance the impact of his crime, with the State first depriving the operator of the ordinary commercial means of protecting itself by taking out insurance, and then confiscating the proceeds of the insurance which the Convention requires the operator to buy.

It has been represented that there is a need to ensure standards of security in the operator's business via the Convention, but this ignores the fact that those standards are set by a licensing authority and supposedly audited by them. The use of confiscatory provisions in a channelling Convention to raise standards, that are properly the object of a regulatory authority, is considerably to pervert the simple purposes of the Convention: delivering compensation to victims by a three layer construct founded on the ability of operators to provide the first layer by taking out and offering out insurance. It should also be borne in mind that the confiscation of property, such as the funds of an insurance policy, is also contrary to the constitutional provisions of various States

2.2 It has also been suggested that the Convention does not strike a fair balance between the interests of the victims and the interests of the airlines and that it lowers the current level of victim protection.

It is true that compensation funds in the aftermath of an accident are paid by insurers to which the operator transferred the risk in exchange for paying a premium. This means that the solvency of the operator in the aftermath of an accident does not affect the payment of compensation which is provided by a different party not otherwise financially directly affected by that accident. This system strikes a fair balance between victims and operators. The insurer provides funds at a time when the financial position of the operator is under pressure. Victims are guaranteed that any advance payments, settlement agreements or court judgments will be satisfied to the extent ordained by law.

Furthermore, the suggestion that, because insurers provide settlement funds, the operator does not pay, is transparently incorrect. The operator pays its insurance premium each and every year in order to secure the availability of compensation funds following an accident. Any suggestion that the funds should come directly from the operator rather than its insurers would destroy the balance between

victims and operators, since on the one hand this would destroy the operator, rendering it incapable of commercial recovery and further contribution to the fund, and on the other hand ties up whatever modest assets the operator may have had in a protracted and expensive liquidation process, further diminishing whatever is left for compensation to victims and payment to other creditors.

2.3 It has been argued that in cases where the operator, its senior management or its servants or agents caused or contributed to the damage by fault it is impossible to justify that the operator benefits from the limitation of liability and victims do not receive any compensation exceeding 3 billion SDR, even although the operator is perfectly able to effect payments. The argument appears to ignore the first layer of the compensation cake provided by the operators' insurance.

The simple justification for the strict liability imposed on the airline is the limit on damages, an approach routinely and effectively adopted in liability Conventions, including those governing passenger legal liability up to and including the Montreal Convention 1999. The Draft Unlawful Interference Convention is based on the premise that operators will be strictly liable up to a limit related to the mass of the aircraft. Any reference to fault liability will dilute the integrity of the system and will expose operators to multiple standards of behaviour within the same legal system.

Furthermore, it is clear that in the current economic climate and the financial situation that the airline industry finds itself in, no operator would be able to effect payments over 3 billion SDRs in the aftermath of a terrorism-related event.

The consequence of the inability of operators to pay claims in excess of 3 billion SDRs, in the absence of a hard cap on liability, would be that the operator would have to be wound up in bankruptcy proceedings. Before any payments at all could be made, all assets would have to be liquidated at value and priority of all claims would have to be calculated. Such a process would take considerable time, preventing the early payment of any compensation.

2.4 It has been stated that the proposed liability concept does not set incentives to improve security measures and in the worst case could prompt operators to reduce security measures as well as the costs spent on those measures

It is not the role of an international civil liability instrument to regulate aviation security. The argument that civil law has a greater deterrent effect than state regulation and the criminal law essentially means that the authority to punish the wrongdoers is transferred from the State to a civil judge, an assumption that undeniably would be contrary to the constitutions of the majority of States of ICAO.

The airline industry strongly refutes the suggestion that it would have an incentive to cut corners when adopting its security measures, when such an attitude would place its own passengers, crew and equipment and indeed its very essence at risk of the consequences of a terrorist attack. In addition, insurers would be reluctant to provide cover to operators whose standards were slipping.

2.5 It has also been suggested that the operator whose aircraft were used in a terrorist attack should have the obligation to refinance the fund.

The Convention does provide for a right of recourse of the SCM against the operator subject to all victims' claims being satisfied and limited to damage that could reasonably have been covered by insurance. This arrangement is entirely satisfactory and ensures that parties who have contributed to a terrorist event will not be absolved, but will bear a reasonable measure of responsibility.

2.6 We understand that it has been suggested that the existence of a limit of liability raises constitutional concerns in certain States.

The concept of limited liability is already enshrined in many international conventions, in particular the Warsaw-Hague and MC99 regime, which have been ratified by more countries than virtually any other international Convention. The proposition that the notion of limited liability causes constitutional concerns appears therefore not to be substantiated.

Furthermore, it is not accurate to suggest that the proposed Convention regime sets an absolute and unbreakable cap on a claimant's ability to recover damages. The claimant may recover damages from the person who actually commits the act of unlawful interference, so terrorist organizations that cause third party losses would remain fully liable for compensation. In any event, the liability cap, which is proposed in the Joint Industry Group paper, is not an absolute, hard cap - it includes exceptions for intentional or reckless acts of senior airline management.

Finally, States with constitutional concerns over the supposed existence of a liability limit can ensure that there is no limit on compensation to individual third party victims by taking responsibility for compensation under the third layer of the proposed convention.

In reality, there is always a practical limit on corporate compensation to victims. Even a confiscatory, punitive system cannot extract more assets from a corporation than it possesses. The assets in the first two layers of the proposed convention are likely to be greater than the assets of an airline which is pushed into bankruptcy following an incident of terrorist interference with its aircraft should a confiscatory convention be adopted.

2.7 The point has been made that the exclusion of liability for the act or omissions of servants and agents contradicts the general concept of liability in international law.

It is not accurate to state that operators would take no responsibility for the acts of agents and servants under the Unlawful Interference Convention. Under Article 3 operators are indeed strictly liable in the first tier, which does include liability for the acts or omissions of their agents and servants.

Furthermore the parallel to the MC99 in the context of this Convention is misconceived. The exclusion of unlimited liability for the acts of servants and agents is balanced by the otherwise unfair and counter-intuitive proposal to impose strict liability on the airline for acts of terrorist interference with its aircraft. If the operator is subject to potentially unlimited liability for the deliberate terrorist acts of mere servants and agents, the hard cap on liability simply evaporates.

We would not disagree that the exclusion of liability for the acts of a corporate entity's servants and agents is a departure from normal liability concepts. However, so too is the imposition of strict liability on an operator for damages resulting from aviation terrorism.

3. EXONERATION OF OTHER SERVICE PROVIDERS

3.1 The exoneration of other entities has been criticised on the basis that they do not contribute to the SCM despite having contributed to the damage. This is a deeply flawed argument and disregards the practical realities of contractual risk allocation.

Lease and purchase agreements for aircraft, as well as other agreements between operators and their various service providers routinely require the operators to provide indemnities to lessors, financiers, manufacturers, and other service providers and to add these parties to the operators' insurance policy as additional insureds.

In normal commercial situations this reduces the overall cost since a single insurance policy takes primary risk of any event, with the insurances of the other parties assuming a supplementary and therefore less premium expensive role.

This means that any liability of these other entities under the Unlawful Interference Convention will not primarily be covered by their own insurance but instead by the operator’s insurers, which will then have multiple exposures. Loading additional exposures on the operator’s policy by means of the Convention does not therefore disbenefit the other entities but simply increases the risk to the insurers of the operator and ultimately to the operator itself.

Once the assets of the operator and the operators policy limit are exhausted then the insurers of the other entities would become liable to pay. This would replicate the situation following 9/11 when 76 aviation entities were sued. However, the consequence of this in a 9/11-type of event is that insurers would withdraw from the market and the other entities would cease to be able to operate. That is precisely one of the significant successes of the 9/11 perpetrators which the Council of ICAO seeks to eliminate by means of this Convention.

Insurers, it must be appreciated, do not have infinite assets, and have an obligation to deploy those assets with commercial rationality. It is also clear that the assets other than insurance of the other entities pale into insignificance by comparison to the liabilities of a 9/11 scale incident. Accordingly, it will be appreciated that the logic of the criticism of the exoneration of other entities would lead inevitably to the grounding of the aviation industry.

3.2 It has been suggested that it is unfair if the operator does not have a right of recourse against other entities who have actually contributed to the damage.

Article 24 of the Draft Convention provides the operator with a right of recourse against the persons who have actually caused the damage, i.e. the terrorists. Again, the industry proposes that there should be a right of recourse of the operator against other entities to the extent of reasonably commercially available insurance. This arrangement is satisfactory to all industry stakeholders.

As the EU discussion paper of October 2008 suggests: “*…the right of recourse should be considered as an issue which is in essence of an intra-industry nature: if all or almost all industry stakeholders involved would in general be satisfied with the current wording, this should be an important consideration for policy makers before suggestions for modification are made*”.[1]

3.3 As stated in paragraph 2.4 above, the proposition that civil tort law should provide the incentives for security would represent an abrogation of the role of the legislative and administrative functions of States in regulating industry and the administration of the criminal law. It is neither an appropriate nor an efficient use of civil court resources to delegate these functions to the civil courts. In many States such an abrogation of powers would also raise serious constitutional issues.

Again, it is not acceptable to suggest that the exoneration concept gives the airline industry any incentive to reduce security measures which would put its end users at risk from terrorist attack.

3.4 It has been argued that any exclusion of liability, which encompasses manufacturers of aircraft, contradicts EC laws on product liability.

The EU discussion paper of October 2008 gives a clear indication that this is not the case: “*the Draft [Unlawful Interference] Convention provides for a protection which in the balance is at least equivalent, if not superior to the one provided for by the product liability Directive*”.[2]

[1] Paragraph 49 of the Discussion Paper.
[2] Paragraph 18 of the Annex to the Discussion Paper.

This statement by the EU leaves no doubt that the provision in the Convention that provides a limited exoneration of manufacturers from liability would not contradict EU laws on product liability. That limited exoneration relates only to matters caused by an "approved" design, where governments have taken a decision. In other cases recourse is available in accordance with applicable law. This concept is analogous to Article 7(d) of the Directive which releases liability in the case of compliance with mandatory regulations.

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