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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INSURANCE AND AVIATION LIABILITY LEGISLATION AMENDMENT BILL 2002

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Transport and Regional Services, the Honourable John Anderson, MP)

INSURANCE AND AVIATION LIABILITY LEGISLATION AMENDMENT BILL 2002

OUTLINE

This Bill proposes minor amendments to the:

- *Civil Aviation (Carriers' Liability) Act 1959* ('Carriers' Liability Act') - to correct a minor technical error in relation to the application of the definitions of Australian citizen and Australian person to charter operators;
- *Damage by Aircraft Act 1999* - to exempt passive owners from liability for damage to third parties on the ground; and
- *Insurance Contracts Act 1984* ('Insurance Contracts Act') - to allow for the exemption, by regulation, of third party aviation war risk insurance from the cancellation and variation provisions of the Act.

1. *Civil Aviation (Carriers' Liability) Act 1959*

The Bill amends the *Civil Aviation (Carriers' Liability) Act 1959* to correct a minor technical error, clarifying the definition of Australian citizen and Australian person. A definition of Australian citizen and Australian person, consistent with the *Air Navigation Act 1920*, is inserted into the Act. Subsections 11A(2) and 21A(2) of the Carriers' Liability Act will then specify that charter operators are only Australian international carriers if they are Australian persons. This will correct an error that imposes an unintended liability under the Act on foreign charter operators which is inconsistent with Australia's international obligations. The correction will apply retrospectively to when the *Aviation Legislation Amendment Act (No. 1) 1998* commenced. This amendment formed part of the lapsed Aviation Legislation Amendment Bill (No1) 2001.

2. *Damage by Aircraft Act 1999*

The Bill amends the *Damage by Aircraft Act 1999* to exclude passive owners (such as financiers and lessors) from liability for damage to third parties on the ground. Following the terrorist attacks in the United States on 11 September 2001, the insurance and finance industry raised concerns about the liability of passive owners for damage on the ground, noting that the Australian practice of having owners and operators jointly and severally liable was not common international practice. The amendment removes the liability of an owner who does not have an active role in the operation of the aircraft immediately before the impact happened, and where another person has the exclusive right to use the aircraft and finance or other arrangements are in place.

3. *Insurance Contracts Act 1984*

Following the events of 11 September aviation war risk insurance for damage on the ground was withdrawn from the global market. Since then some war risk insurance has become available commercially. However, major Australian airports and other Australian-based aviation service providers have been unable to purchase sufficient war risk (including terrorism and hi-jacking) insurance. This is due to the provisions of section 53, on non-variation, and section 63, on non-cancellation, of the *Insurance Contracts Act 1984* which

prevent insurance contracts being varied or cancelled mid-stream. Normal international industry practice is to have a seven-day or thirty-day cancellation clause in the insurance contract in case there is some unforeseen catastrophic event. The protection offered by the Insurance Contracts Act against cancellation of insurance policies has resulted in Australian-based airlines, airports and other aviation services providers that obtain their insurance from the international market being unable to obtain cover once their existing contracts come up for renewal.

The Bill provides for the exemption, by regulation, of war and terrorism risk insurance from the cancellation and variation provisions of the Insurance Contracts Act. Exempting war and terrorism cover from the cancellation and variation provisions of the Act will place this class of insurance in the same position as the rest of the world, and will enable Australian operators to access global markets for insurance.

The Government is pursuing, along with many similar-minded countries, a global coordinated solution to terrorism insurance. In the meantime, the Government is offering war risk indemnities to those aviation industry participants that have been unable to obtain adequate war risk cover.

FINANCIAL IMPACT STATEMENT

There is no financial impact from these amendments.

REGULATION IMPACT STATEMENT

Note – an earlier version of the Regulation Impact Statement, covering also the introduction of a charging regime for the provision of Commonwealth third party war risk indemnities provided to the aviation sector, can be found at http://www.dotars.gov.au/avnapt/ipb/ipb.htm

This Regulation Impact Statement has been prepared by the Department of Transport and Regional Services (DOTARS) with the assistance of the Treasury.

A. The Problem

The Australian aviation industry (airlines, airports and service providers) is currently facing major difficulties obtaining sufficient third party aviation war or terrorism risk (ie, for damage caused on the ground). In most part, this is a result of the insurance industry taking a highly conservative approach to aviation insurance since the events of 11 September 2001.

The problem is not so much that the Australian insurance industry is not willing to provide cover – it is that the international market is no longer prepared, in the changed circumstances post-11 September, to offer sufficient cover to the market. As the Australian market is not large enough by itself to provide sufficient amounts of cover, particularly re-insurance which is essential when cover measured in the 100s of millions of dollars is involved, we are dependent upon the international market and fully exposed to international conditions. The problems being faced by the Australian aviation industry are identical to those being faced by

their counterparts in other countries around the world. The solutions being pursued by the Australian Government are also mirrored elsewhere.

There are, however, also some specific issues which are restricting access for the Australian industry to the limited amount of cover that is available on world markets and this Regulation Impact Statement outlines the steps – minor amendments to two pieces of legislation – that are proposed to be taken.

The following assessment of the problem is divided into two sections. The first outlines the basic problem and discusses Government actions already taken, while the second addresses the problems that are affecting the ability of the Australian aviation industry to access what war risk cover may be available.

Problem 1. Lack of cover in the global market

In the immediate aftermath of the events of 11 September 2001, the global insurance industry acted to withdraw aviation war risk insurance. Prior to the attacks, war, hi-jacking and other perils (including terrorism) were excluded from the standard aviation policy but airlines, airports and other aviation service providers could purchase optional war risk write back cover for these third party claims. Following the attacks, all insurers reduced the cover under this write back for airlines to passenger liability and a mere US$50 million for third party ground damage. Most countries have strict liability regimes for ground damage caused by aircraft, regardless of the circumstances, with many requiring aircraft operators to hold a minimum level of insurance to fly in their airspace[1]. Upward of US$60 billion of claims are being considered by insurers as a result of the WTC attacks. In view of the potential damages, illustrated by these attacks, most world airlines, including Qantas, were unwilling to continue to operate without adequate insurance. Cover for airports was initially fully withdrawn, due to concern over potential negligence claims arising from the security screening at Boston's Logan airport, although US$50 million in cover was eventually restored by primary insurers.

In the wake of these events, the Government took the decision to provide war risk indemnity cover for third party damage on the ground to those operators in the aviation sector who had lost their coverage. This response was made to prevent acts of terrorism undermining the aviation and tourism sectors as well as to maintain collective confidence in the aviation sector, and was consistent with approaches adopted through-out the world. Air carriers, airports and all key service and facility providers associated with the aviation sector that held third party war risk insurance cover prior to its cancellation on 24 September 2001 are eligible for the Commonwealth's indemnity. A copy of the relevant criteria announced by the Government at the time is at Attachment A.

The Commonwealth indemnity is designed as a short term intervention to address one commercial consequence of the terrorist attacks. It covers the gap between the insurance available in the market and the level of insurance held prior to the worldwide withdrawal of war risk insurance. This approach avoids the Commonwealth having to determine an appropriate upper limit of war risk cover. This should be a commercial decision for industry

1 Australia does not impose a minimum level of insurance on airlines, but does require all holders of an International Airline Licence to provide details of insurance held. A Licence is not issued unless the airline can demonstrate that its insurance cover is consistent with global practice – normally all risks of between US$1 – 2 billion per single incident.

participants and the limit is effectively set by reference to the amount of cover held before 11 September.

Officials have been monitoring the market regularly and all indemnities were initially rolled over on a monthly basis, with recipients being required to advise the Commonwealth regularly on their efforts to obtain commercial cover. Recipients of a Commonwealth indemnity are also required to take out commercial cover as it becomes available, as determined by the Commonwealth.

The notional upper limit of the Government's contingent liability for these indemnities is currently A$ 0.6 billion, based on the difference between the amount of insurance available commercially and the entity's previous level of cover. The individual contingent liabilities range from A$100 million to A$2 billion. It is extremely unlikely that the total liability would be called upon as facilities are spread across Australia, although a terrorist incident could involve claims from several indemnified parties.

In addition to cover for US$50 million for any one occurrence over one year from the primary insurers, layers of war risk insurance are now available up to US$1 billion for both airlines and other service providers. At present this cover is only available from a limited number of insurers and at significantly higher premiums. It appears that additional layers are being developed up to US$2 billion for airlines, however, details are yet to be confirmed. There are also reports of other major insurers developing new products for airlines up to US$1 billion. For passenger aircraft the premium is based on passenger movements per segment, and for cargo carriers on a tonnage basis. Both Virgin and Qantas are charging passengers an 'insurance levy' in response to significantly increased insurance costs. For airports, manufacturers and service providers, premiums are being quoted on a case-by-case basis.

These developments are encouraging, but the commercial market for war risk insurance is far from restored. Because of the nature of the insurance industry, and the way war risk cover has been provided in the past, third party war risk cover is not a commodity that can be purchased "off the shelf". As mentioned above, industry participants need to take commercial decisions on where to place their primary insurances, and then seek to obtain war risk cover as a "write-back" on their primary cover. As there are only a limited number of firms offering sufficient cover, and then often on restricted terms, many industry participants worldwide are only able to obtain the basic US$50 million of cover – which is of little commercial value when international airlines generally require US$1-2 billion.

Indemnities of one form or another are being provided by Governments in Europe, North America and Asia along the lines of those provided by the Australian Government. The state of the international market is kept under close review by, in particular, the European Union and the US and both have recently decided that there is not yet sufficient stability in the market to withdraw indemnity protection for their aviation industry.

One point needs to be clarified in relation to the availability of commercial war risk cover. While some administrations in other countries may consider it relevant, the Australian Government approach has been to ignore the issue of the cost of commercial war risk cover. It is beyond doubt that the costs of aviation insurance have risen across the board following the events of 11 September 2001 and the cost of the war risk write back has probably increased out of all proportion to the cost of primary cover. This is partly because the

industry has realised it had grossly underpriced this cover in the past. There is also an element of the insurance industry trying to re-build its reserves after a disastrous period.

Aviation industry recipients of an indemnity from the Commonwealth are being required to take out available commercial insurance and are being advised that the cost of this cover cannot be accepted as a reason for not taking it up.

Various regional and global alternatives to commercial cover are being explored. The International Civil Aviation Organization (ICAO) is developing a scheme, in concert with the major insurance brokers, whereby aviation war risk coverage would be provided by a non-profit company with multilateral government backing. The company's sole purpose would be to offer third-party war risk liability cover, up to US$1.5 billion in excess of US$50 million per insured. The amount of commercial cover required would progressively increase to facilitate a return of the commercial market. The company's insurance cover would be available to the entire aviation sector of any ICAO Contracting State that joins the Scheme.

At the same time, the US and Europe are investigating regional schemes (Equitime and Eurotime respectively) that have some of the features of the ICAO scheme and, to varying degrees, are compatible with it.

The Australian Government has announced (press release of 10 May 2002 by the Hon John Anderson MP, Deputy Prime Minister and Minister for Transport and Regional Services) strong support for the ICAO scheme as offering a firm foundation for the aviation industry until the insurance market is able to recover from the events of 11 September 2001.

At the same time, Mr Anderson announced that the Government had decided to extend its indemnity scheme by three months at a time until a suitable long term solution is established. It also decided to charge for the cover it will be providing, with the details of the charging regime still to be settled. The imposition of a charge is consistent with the Government's prime focus which is to see the return of the market at the earliest possible time. Continued provision of indemnities for free would have been most inimical to the re-establishment of a viable commercial market for third party war risk insurance in Australia. The charge is also intended to provide some recompense to the Government for the indemnities provided, but it in no way should be seen as being a "premium".

Recipients of indemnities were provided with advance warning, in April, that a charge was likely to be imposed and all stakeholders, including representatives from insurers, were consulted on the design of the charging regime which came into effect, along with revised Deeds of Indemnity providing for a three month period of operation, from 31 August 2002.

Problem 2. Specific difficulties facing the Australian aviation industry

2(a) <u>Insurance Contracts Act 1984</u>

The international insurance market has baulked at the *Insurance Contracts Act* 1984 (the IC Act) which prohibits (s.63) the cancellation of a contract of insurance unless the insured has failed to comply with the duty of utmost good faith; non-disclosure or misrepresentation; or fraud. The IC Act also voids (s.53) any provisions which allow the insurer to vary a contract of insurance to the prejudice of a person other than the insurer.

As mentioned above, the immediate response of international underwriters to the terrorist attacks was to, in accord with standard clauses in contracts, give seven days notice of cancellation of aviation war risk cover. Although Australian firms also were affected by this global response, contracts subject to the IC Act had to be re-instated when the provisions of the Act were brought to the attention of insurers. This, of course, provided only temporary relief for Australian firms – the international market simply refused to renew such contracts when they fell due. And all such firms have approached the Government for indemnity cover.

Commercial cover has started to return as the industry re-evaluates risks and premiums – and competitive forces begin to re-assert themselves. However, international underwriters have proven to be not interested in providing coverage to Australian firms whilst the IC Act prohibits them from taking action to protect their interests in the event of another major incident. In other words, the international insurance market is no longer prepared to provide non-standard cover to Australian risks.

2(b) Damage by Aircraft Act 1999

The Australian Equipment Lessors Association (AELA) and several international aircraft financiers have raised concerns over the application of the *Damage by Aircraft Act* 1999 (DA Act) to passive owners (lessors and financiers). The DA Act imposes absolute liability on owners and operators (who are jointly and severally liable) of aircraft that cause injury to persons and damage to property on the ground. The Act was developed over a number of years and subject to an extensive aviation industry consultation process. At no stage during that process, nor during its passage through Parliament, did anyone raise any objections to the rule as formulated. We surmise that it was not an issue due to the availability of adequate commercial insurance to cover all risks, including war and terrorism.

However, since 11 September 2001, Australia has been identified as one of four countries (the others being Greece, Norway and Denmark) that impose liability on passive lessor owners. In the immediate aftermath, international aircraft leasing companies were threatening to cease operations by their aircraft in, and over, these countries. Apart from Australian registered aircraft, this threatened operations into Australia by a number of foreign carriers. To date, international lessors have been satisfied by the assurance that the matter is being considered by the Government but a resolution to these concerns needs to be found.

B. Discussion of Government Objectives

In order to understand the alternatives considered and the final actions taken, it is necessary to review the underlying objectives of Government policy in responding to the insurance crisis affecting the aviation industry.

In the first place, the Australian aviation industry is highly deregulated when compared to international counterparts. Now that Sydney Airport has been sold, all major airports have been leased to the private sector and the Commonwealth has virtually completed a long term programme to transfer ownership and operation of all airports to the private sector and/or local government (the other Sydney basin airports remain). There are no regulatory restrictions on the number of service providers (ground handling, security, etc) at airports. There is no economic regulation restricting entry to the domestic airline market and, in fact, Australia is almost unique in permitting foreign airlines to establish domestic airlines. There

are also no economic restrictions on new Australian international airlines wishing to enter the market and we maintain a very open access regime providing access to Australia for foreign international airlines.

The Australian aviation industry is exposed to international market pressures as much as possible, in the main because aviation is a global industry and Government has no interest in unsustainable protection mechanisms that defy market realities.

With that broad background, there are some specific policy considerations that apply to the areas of concern dealt with by this Statement.

Provision of Indemnities

The Australian Government's decision to provide war risk indemnity cover for third party damage on the ground to those operators in the aviation sector who had lost their coverage was fully in accord with international practice. There was no practical alternative for Australia – airlines, airports and service providers would have faced the prospect of ceasing operations without adequate cover. Any such action would, in the main, have been a commercial decision for the various enterprises concerned, although some operators are required by finance providers (or, in the case of major airports – the Commonwealth as owner) to have such insurance.

From the beginning, the Government's objective was to provide necessary support to the industry until a commercial market was able to be re-established. The very design of the indemnity regime supported an early return of commercial insurance in that the Government has only provided cover for the gap between the insurance available in the market and the level of insurance held by the particular enterprise prior to the worldwide withdrawal of war risk insurance. In addition, the Commonwealth has increased the level of insurance to be held in order to qualify for continued cover as more cover became available on the market.

While the current indemnity scheme contains a requirement for participants to seek commercial cover, the fact that it had been provided at no charge was regarded as a disincentive for recipients and the insurance industry to support the return of a commercial market. All of the interim schemes proposed internationally (the ICAO scheme, the US Equitime and the EU Eurotime) incorporate charges. The current indemnity scheme operated by the US Federal Aviation Administration involved a US$7.50 charge per movement which has now been substantially increased.

Insurance Contracts Act – cancellation and variation provisions

The IC Act provides protection to Australian business and consumers alike. However, the Act recognises that certain classes of insurance cannot be regulated like others and, in particular, s.9(3) excludes from the cancellation provision (amongst others) contracts of insurance against the risk of the loss of an aircraft, or damage to the hull of an aircraft, as a result of war. This provision was made in recognition of the fact that such insurance is only readily available on global markets and would probably not be available to Australian carriers if such insurance had to comply with the non-cancellation regime of the Act. While insurance cover for aircraft was excluded from the operation of the IC Act, at the time the IC Act was passed, third party cover for the related on-the-ground war risk was not included in the initial exemption.

It is probably the case that the international insurance industry had not been aware of the relevance of the IC Act to their business in Australia until the effect of ss53 (variation) and 63 (cancellation) were pointed out. Following the 11 September 2001 terrorist attacks in the United States, the full impact of these provisions became obvious to the Australian aviation industry, and they found it increasingly difficult to access what third party war risk insurance was available on the international market. DOTARS has been advised by industry and insurance representatives that many underwriters in the London market, who are happy to offer cover elsewhere, will simply not provide cover to Australian firms. It would not be desirable for the legislation in Australia to continue to impose an artificial barrier to customers seeking the terrorism cover that would otherwise be available to them in the international insurance market.

Damage by Aircraft Act – liability of lessors, etc

The Damage by Aircraft Act was enacted to reform the regime of liability of aircraft operators for damage caused on the ground. The previous regime, set out by the *Civil Aviation (Damage by Aircraft)* Act 1958 and the *Convention on Damage caused by Foreign Aircraft to Third Parties on the Surface* (the *Rome Convention 1952*), had not kept pace with modern thinking on liability. The Rome Convention had been developed to provide internationally harmonious arrangements to ensure adequate compensation for persons who suffer damage caused on the ground by foreign aircraft, while limiting the extent of the liabilities incurred for such damage in order not to hinder the development of international civil air transport. Australia had been a Party to the Rome Convention since 8 February 1959. However, the Convention no longer met Australia's needs as it had failed to meet its objective of international uniformity in the treatment of claims by third parties on the ground, as only 43 States were Parties and its limits on liability were too restrictive, outdated and inappropriate.

The DA Act, which came into force in 2000, introduced a regime of strict and unlimited liability for injury and damage caused by aircraft. There is no definition of "owner" in the Act, and the effect is that financiers or lessors are caught by the joint and several liability of owners and operators imposed by s. 10(2). The intention at the time had been to ensure that, no matter what, someone was held liable without the need for Government to design a system to apportion responsibility. In short, it was considered that the operation of the commercial marketplace would ensure that appropriate levels of insurance were carried to protect the interests of those parties likely to be held liable in the event of an accident. The DA Act had the full support of all players in the aviation and insurance industries at the time.

The Commonwealth's objective has not changed, but it has become clear after the clarifying events of 11 September 2001 that financiers and lessors need to have a mechanism to more effectively manage their liability, particularly in cases where they do not actively participate in the operation of the aircraft assets concerned.

C. Discussion of Options and Action Taken

2(a) *Insurance Contracts Act 1984*

Possible options are:

1. Do nothing.

This would mean that third party war risk insurance would remain non-cancellable in Australia, thus providing a continued measure of protection to Australian firms. However, it has become apparent that international insurance providers will not renew existing contracts as they fall due, thus depriving Australian aviation firms of access to the little cover that has returned to the market. In general, this will mean that most firms will not be able to obtain more than the A$50 million cover that is being offered locally. Anything in excess of this amount could only be provided by the larger international pools and is unlikely to be offered.

2. Make a regulation to exempt third party aviation war risk insurance from s.53 of the IC Act (prohibition against variation of contracts), thus assisting Australian airports and other affected parties to purchase war risk write back cover from the global market.

This option is being pursued by the Treasurer as an immediate and intermediate step as it would allow insurance providers to vary contracts as a "second best" step to removing the prohibition against cancellation. Contacts in the global insurance market suggest this may assist some parts of the Australian industry to gain access to better cover, but is not seen as the total solution to the problem.

3. Amend the IC Act to exempt third party aviation war risk insurance from the cancellation and variation provisions.

This is regarded as the best long term solution as it would place Australian aviation firms in the same position as the rest of the world, thus providing no reason why the global insurance market should discriminate against Australian industry.

The Insurance and Aviation Liability Legislation Amendment Bill 2002 (clause 6) proposes to amend section 9 of the Insurance Contracts Act 1984 to provide that ss 53 and 63 do not apply to prescribed insurance provisions providing cover for war or terrorism risk. Passage of this provision will be followed by a regulation prescribing aviation third party war and terrorism risk cover, thus bringing this class of insurance into line with international practice. The provision is drafted to provide scope to extend this treatment to other types of war or terrorism cover if necessary.

2(b) Damage by Aircraft Act 1999

Possible options are:

1. Do nothing.

As a direct consequence of 11 September 2001, the global aviation insurance and finance industries are now much more sensitive to liability questions. Leaving passive owners (ie, lessors or financiers) exposed to third party liability risks would threaten to reduce the availability of economical aircraft finance to the Australian aviation sector. It may also affect the Australian operations of some overseas airlines when financiers fear terrorist action.

2. Amend the DA Act to exclude passive owners (such as lessors) from liability for damage on the ground.

This is the action decided upon by the Government. The Insurance and Aviation Liability Legislation Amendment Bill 2002 (clause 5) inserts a provision to exclude passive owners from liability.

D. Impact Analysis

2(a) Insurance Contracts Act 1984
2(b) Damage by Aircraft Act 1999

The minor amendments proposed to the Damage by Aircraft and Insurance Contracts Acts will remove impediments to Australian aviation enterprises gaining full access to the international insurance market for third party war risk insurance and resolve concerns of the finance industry about their liability. The amendments will mean that insurers, re-insurers and financiers will be able to deal with insurance or leasing proposals from the Australian aviation industry in the same manner as the rest of the world and are expected to largely resolve the current shortage of war risk cover for most sectors of the industry.

In the case of the Damage by Aircraft Act, excluding the liability of passive owners has the effect of leaving the operator solely liable in the event of damage on the ground. There is no statutory requirement in the legislation to maintain insurance for damage caused on the ground – the liability being unlimited would make this is a difficult task to administer in any case. However, advice from the finance industry is that it is standard practice for lessors or security holders to require that the operator of the aircraft maintain adequate insurance for all risks, with the amount of cover determined by widespread industry practice. While it is not proposed that the question of mandatory insurance be addressed at this time, this is a matter that will be covered in the Government's consideration of the ratification of the Montreal Convention 1999. A Discussion Paper on the question of ratification of the Convention, issued by DOTARS in January 2001, canvassed a number of other liability and insurance issues, including the question of mandatory insurance cover.

In the case of the IC Act, Treasury is consulting closely with the industry on the terms of the regulation on variation of contracts to ensure it is appropriately focussed on war risk and does not inadvertently remove other desirable protections from the industry. The amendment to the Act has also been targeted on war and terrorism risk insurance for the same reason.

While these changes will expose the aviation industry to the threat of variations and/or cancellation of their insurances in the event of another major terrorist attack, it is the judgement of both Government and the industry that these moves are necessary in order for the Australian industry to have access to the global market.

The amendments have the strong support of the Australian aviation industry, as well as Australian-based insurers who expect to be able to access the larger international market in order to meet the demands of local clients. In fact, Government is responding to specific requests from insurers and lessors in pursuing these amendments.

The Government does not, however, accept that exposing the aviation industry to the risk of cancellation or variation of third party war and terrorism risk insurance solves the problem – it merely enables our industry to operate on the same terms as the global aviation industry. In the medium to longer term, a solution must be found to the issue of war and terrorism insurance that does not unreasonably expose the industry to the threat of global closure and that is why Australia is a major contributor to the work initiated by ICAO to develop a global scheme based around a non-profit company with multilateral government backing. This scheme is seen as the medium term solution because it is intended to include provisions to deal with another global crisis in aviation insurance and it is also meant to offer a transition to a more permanent solution – yet to be worked out between Governments and the industry.

E. Consultation

Affected participants in the aviation industry and the Australian insurance industry have been closely consulted at all stages of this process. Industry meetings have been convened regularly to update indemnity holders on international developments and seek views on the best way forward for the management of the crisis in Australia.

As mentioned above, the two legislative amendments have been pursued at the urging of the industry, with their full support and with their active assistance in finalising the drafting. An exposure draft of the Bill was circulated to industry participants in September 2002 for comment and, apart from technical suggestions, all responses received were supportive. DOTARS worked with the Office of Parliamentary Counsel to explore all the suggestions made and all have been resolved.

One issue that concerned two industry participants was the terms of the proposed regulation under the IC Act. It was pointed out that a regulation that was drafted too widely, say covering “aviation insurance”, may permit insurance companies to cancel a variety of aviation policies, and not just third party war or terrorism. All industry participants have been advised that they will be consulted over the terms of the regulation by Treasury and it is proposed to expressly refer to third party aviation war or terrorism risk, either by direct reference to the standard industry clause, AVN52, or by listing the war and terrorism risks to be covered. This will ensure that industry concerns are fully addressed in this instance, while retaining some degree of flexibility should the need arise in the future.

A number of suggestions were made that led to improvements in the drafting of the provision amending the Damage by Aircraft Act so that it is properly focussed on excluding the liability of passive owners.

F. Implementation and Review

2(a) *Insurance Contracts Act 1984*
2(b) *Damage by Aircraft Act 1999*

It had been intended that a regulation to permit variation of war risk contracts, as an interim measure, be in place by 30 June 2002. This was not possible because of continuing discussions with industry and insurers over the breadth of the coverage of the regulation and concerns to avoid too wide an effect. The final draft of the regulation was circulated for industry comment in September 2002.

As mentioned above, the industry will be consulted by Treasury over the drafting of a regulation under the proposed amendment to section 9 of the IC Act and special attention will be paid to ensure it is appropriately targeted.

No specific plans have been made for longer term review, but Australia will be fully participating in work under the auspices of ICAO to review the international law in relation to damage on the ground, including the question of liability limits and appropriate insurance. DOTARS will build upon industry contacts established through the war risk issue to ensure wide stakeholder input to any Australian position on these matters.

ATTACHMENT A

AVIATION WAR RISK INDEMNITY – CRITERIA

Following the 11 September 2001 terrorist events in the United States, existing aviation war risk insurance (including terrorism and hijacking) was withdrawn from the global marketplace from 24 September or shortly thereafter. To ensure continuity of operations, the Commonwealth agreed to provide third party war, terrorist and hijacking indemnity cover for damage on the ground to airlines, airports, and other service and facilities providers. The current indemnity is provided on a month to month basis.

Is my organisation eligible?

Air carriers, airports and all key service and facility providers associated with the aviation sector that held third party war risk insurance cover prior to its cancellation on 24 September 2001 are eligible for the Commonwealth's indemnity.

This includes:

- Civil Aviation Safety Authority (CASA) and Airservices Australia;
- Airport operators, including leased federal airports and smaller regional airports;
- Security screening companies operating at Australian airports;
- Freight forwarders and cargo agents; and
- Ground handling agents.

In addition organisations which have recently been appointed as aviation security screening authorities are also eligible.

Will my organisation need to purchase any war risk insurance from the market?

You are required to purchase commercial war risk insurance cover from the market as it becomes available, as determined by the Commonwealth. In line with the increasing level of coverage offered by the insurance market, the Commonwealth intends to progressively increase the amount of coverage you will be required to purchase commercially in order to remain eligible for its war risk indemnity.

What does my organisation need to do throughout the term of the indemnity?

You are required to actively seek war risk insurance from the market as outlined above AND report to the Commonwealth fortnightly through established mechanisms on your efforts to do so.

What does the indemnity cover?

The Government's policy decision provides indemnities that are limited to the least amount of the following applicable criteria.

The indemnity covers the gap between the amount of third party war risk insurance available commercially and:

For those who held war risk cover under AVN52 C on 24 September 2001, where the main aviation insurance policy is still current:

the level of war risk cover held by the organisation pre 24 September 2001. The circumstances covered by the indemnities are consistent with the terms of the pre-existing cover;

For other eligible organisations, including those that have renewed their aviation insurance cover:

the organisation's level of cover for all risks as defined by its main/general aviation insurance policy, subject to the following maximum caps:

- US$500 million for carriers operating aircraft with 50 seats or less;
- US$1 billion for firms with operations within Australia only, operating aircraft with more than 50 seats;
- US$2 billion for firms with domestic and international operations;

For newly appointed screening authorities:

the organisation's level of cover for all risks as defined by its main/general aviation insurance policy, where an organisation did not have separate insurance before 11 September.

INSURANCE AND AVIATION LIABILITY LEGISLATION AMENDMENT BILL 2002

NOTES ON CLAUSES

Clause 1 - Short title

Clause 1 provides that the Bill, once enacted, may be cited as the *Insurance and Aviation Liability Legislation Amendment Act 2002*.

Clause 2 - Commencement

This clause provides that sections 1 - 4, and items 5 and 6 of Schedule 1 of the Act will commence on the day the Act receives the Royal Assent, and items 1 - 4 of Schedule 1 are taken to have commenced at the same time as Schedule 4 of the *Aviation Legislation Amendment Act (No.1) 1998* commenced.

Clause 3 - Schedules

This clause specifies that each Act specified in a Schedule to the Act is amended or repealed as set out in the Schedule concerned.

Clause 4 - Application

This clause provides that the amendment to the *Insurance Contracts Act 1984* by item 6 of Schedule 1 applies to a contract of insurance entered into after the commencement of the item, including variations to a contract which was entered into prior to the commencement of the item.

SCHEDULE 1 - AMENDMENTS

Civil Aviation (Carriers' Liability) Act 1959

Items 1 and 2 of the Schedule define 'Australian citizen' and 'Australian person'. The purpose of these items is to modify the definition of Australian international carrier in paragraphs 11A(2)(b) and 21A(2)(b) of the *Civil Aviation (Carriers' Liability) Act 1959* (Carriers' Liability Act) by clarifying that charter operators are only Australian international carriers if they are Australian persons.

Item 1 - Section 5

This item provides that an Australian citizen in the Carriers' Liability Act is the same as an Australian citizen defined in the *Australian Citizenship Act 1948*.

Item 2 - Section 5

This item defines an Australian person in the same terms as the *Air Navigation Act 1920*.

Item 3 - Subsection 11A(2)

This item clarifies that the provisions of 11A of the Carriers' Liability Act apply to international charter operators who are an Australian person.

Item 4 - Subsection 21A(2)

This item clarifies that the provisions of 21A of the Carriers' Liability Act apply to international charter operators who are an Australian person.

Damage by Aircraft Act 1999

Item 5 - After subsection 10(2)

This item provides an exemption for the owner of an aircraft who did not have an active role in the operation of the aircraft immediately before the impact happened. The intent is to ensure that a passive owner of an aircraft (such as a person who leased the aircraft, or provided finance or other arrangements with another person who has the exclusive right to use the aircraft) is not liable for injury, loss, damage or destruction to third parties on the ground.

Insurance Contracts Act 1984

Item 6 - At the end of section 9

This item provides for cover for risks relating to war and terrorism to be excluded from section 53 (Variation of contracts of insurance), and section 63 (Cancellations void) of the *Insurance Contracts Act 1984* where prescribed or otherwise identified by regulation.