

Calendar No. 377

109TH CONGRESS }
2d Session }

SENATE

{ REPORT
109-223 }

WAR RISK INSURANCE

R E P O R T

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND
TRANSPORTATION

ON

S. 1102



MARCH 27, 2006.—Ordered to be printed

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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WAR RISK INSURANCE

MARCH 27, 2006.—Ordered to be printed

Mr. STEVENS, from the Committee on Commerce, Science, and
Transportation, submitted the following

R E P O R T

[To accompany S. 1102]

The Committee on Commerce, Science, and Transportation, to which was referred the bill (S. 1102) to extend the aviation war risk insurance program for 3 years, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

PURPOSE OF THE BILL

The measure would extend the authority of the Secretary of Transportation (Secretary) to issue war risk insurance policies to air carriers. Additionally, the measure would extend the Secretary's authority to certify that an air carrier is a victim of an act of terrorism and shall not be liable for losses suffered by third parties. The measure also extends the Secretary's authority to certify immunity from punitive damages that exceed \$100,000,000. The measure would extend the Secretary's authority through December 31, 2008.

BACKGROUND AND NEEDS

Aviation war risk insurance provides coverage for acts of violence against airlines such as terrorism, hijackings, and sabotage. War risk coverage benefits apply to airlines, persons on the ground, and property where such third parties suffer losses that result from acts of violence against an airline.

Airlines cannot operate without war risk insurance. Aircraft loan and lease agreements typically require airlines to obtain and maintain such insurance. Additionally, some foreign countries require that airlines have war risk insurance as a condition to operate in

their airspace or at their airports. Air carriers have traditionally provided some degree of insurance self-coverage, but they are reliant on the larger insurance and reinsurance markets to provide catastrophic coverage.

On September 22, 2001, Congress enacted H.R. 2926, the September 11th Victim Compensation Fund of 2001 (P.L. 107-42) that authorized the Federal Aviation Administration (FAA) to issue insurance for both domestic and international commercial air carrier operations. Previously, FAA authority was limited to international operations. P.L. 107-42 also enacted a \$100,000,000 act-of-terrorism liability limitation for U.S. airlines with respect to damage to people and property on the ground. Airlines remained fully responsible for passenger liability. Beginning on September 24, 2001, the FAA began issuing war risk insurance. It continued to do so for 60-day periods thereafter.

In H.R. 5005 the Homeland Security Act of 2002 (P.L. 107-296), Congress concluded that continued short-term administrative extensions of the FAA-issued policies were unsatisfactory and instructed the FAA to provide war-risk coverage through August 31, 2003, with the discretion to extend the coverage through December 31, 2003.

In H.R. 1559, the Emergency Wartime Supplemental Appropriations Act of 2003 (P.L. 108-11), Congress extended each of those dates by one year to August 31, 2004, and December 31, 2004. Congress also extended the \$100,000,000 act-of-terrorism liability cap.

In H.R. 2115, Vision 100—Century of Aviation Reauthorization Act (P.L. 108-176), Congress amended section 44310 to allow the Department of Transportation (DOT) to provide war risk insurance to a U.S. aircraft manufacturer for loss of an aircraft of a U.S. airliner in excess of \$50,000,000 or in excess of the manufacturer's primary insurance. The manufacturer program was extended and made effective until March 30, 2008.

In H.R. 4818, the Consolidated Appropriations Act of 2005 (P.L. 108-447), Congress continued a mandatory extension of the war risk insurance program, and eliminated expansion of the program to aircraft manufacturers and associated entities. The agreement extended existing terms and conditions of the program for one year, until August 31, 2005, with the Secretary given the option of extending it until December 31, 2005. Under that option, the Secretary continues to have the authority to extend war risk insurance to aircraft manufacturers at his discretion.

On November 18, 2005, Congress passed H.R. 3058 the Transportation, Treasury, the Judiciary, Housing and Urban Development, and related agencies Appropriations bill of 2006 (P.L. 109-115). H.R. 3058 extended the terms and conditions of the aviation war risk insurance program, along with the limitation on air carrier liability for third party claims arising out of acts of terrorism to August 31, 2006. H.R. 3058 also includes an option for the Secretary to further extend the program until December 31, 2006.

Since the terrorist attacks of September 11, 2001, the commercial insurance market has not provided war risk coverage with terms that commercial air carriers deem financially reasonable or bearable. Market analysis suggests that commercial air carriers can currently only obtain commercial insurance coverage at several times current premiums with far less favorable terms. Industry

data suggests a return to the commercial market to obtain war risk insurance could cost U.S. airlines \$600,000,000 to \$700,000,000 in premiums annually compared with the current cost of \$140,000,000 provided by the U.S. DOT. Since its inception, the FAA's war risk program has saved the struggling U.S. air carrier industry hundreds of millions in annual expenses and produced a net benefit to the Federal Treasury.

The Committee recognizes U.S. that airlines continue to represent the prime aviation target for acts of foreign-based terrorism and the commercial market for aviation war risk insurance remains insecure. The Committee also recognizes the private aviation insurance market is highly specialized. While aviation war risk insurance coverage is now generally available from private insurers, premium rates continue to remain unreasonably high. Also, commercial hull insurance coverage for occurrences involving weapons of mass destruction is now being withdrawn from the market.

The Congress is providing for a temporary extension of the existing program because coverage currently available is only available at rates that remain unreasonably high.

The Committee encourages DOT to identify and evaluate methods for a gradual reintroduction to the commercial insurance market and to provide annual reports to the Committee on the availability of reasonably priced war risk insurance.

LEGISLATIVE HISTORY

The bill, S. 1102, was ordered to be reported without amendment favorably to the Senate by voice vote on November 17, 2005, in the presence of a quorum.

ESTIMATED COSTS

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and section 403 of the Congressional Budget Act of 1974, the Committee provides the following cost estimate, prepared by the Congressional Budget Office:

JANUARY 10, 2006.

Hon. TED STEVENS,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1102, a bill to extend the aviation war risk insurance program for three years.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Megan Carroll.

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

S. 1102—A bill to extend the aviation war risk insurance program for three years

Summary: S. 1102 would extend, through December 31, 2008, the Federal Aviation Administration's (FAA's) authority to offer insurance to air carriers and certain manufacturers against liability

arising from losses caused by terrorist events. CBO estimates that enacting S. 1102 would increase direct spending by \$710 million over the 2007–2015 period. Enacting the bill would not affect revenues.

S. 1102 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 1102 is shown in the following table. The costs of this legislation fall within budget function 400 (transportation).

| | By fiscal years, in millions of dollars— | | | | | | | | | |
|----------------------------------|--|-------|------|------|------|------|------|------|------|------|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| | CHANGES IN DIRECT SPENDING | | | | | | | | | |
| Estimated Budget Authority | 0 | – 125 | 5 | 270 | 210 | 140 | 100 | 60 | 30 | 20 |
| Estimated Outlays | 0 | – 125 | 5 | 270 | 210 | 140 | 100 | 60 | 30 | 20 |

Basis of estimate: The FAA offers insurance to air carriers and manufacturers of aircraft and aircraft engines against liability arising from losses caused by terrorist events. Under the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006 (Public Law 109–115), the FAA already has authority to offer that insurance through December 31, 2006. S. 1102 would extend the FAA’s authority to offer terrorism insurance through December 31, 2008. Assuming the agency would provide insurance through that date, we estimate that the net cost to the federal government would total \$710 million over the 2007–2015 period.

Currently, the FAA collects premiums from air carriers and manufacturers in exchange for insurance coverage. Such premiums are recorded as an offset to direct spending in the year that they are collected. Based on information from the FAA about rates charged for coverage, CBO estimates that under S. 1102, the agency would collect about \$340 million in additional premiums over the 2007–2008 period. CBO expects that the potential cost of providing insurance, however, would be much greater than premiums collected. CBO estimates that payments for expected losses under the FAA insurance program would cost nearly \$1.1 billion over the 2007–2015 period, with residual spending in later years.

CBO cannot predict how much insured damage terrorists might cause to air carriers and aircraft engine manufacturers in any specific year. Instead, our estimate of the cost of the insurance coverage under S. 1102 represents an expected value of payments from the program—a weighted average that reflects the probabilities of various outcomes, from zero damages up to very large damages due to possible future terrorist attacks. The expected value can be thought of as the amount of an insurance premium that would be necessary to just offset the risk of providing this insurance; indeed, our estimate of the expected cost for S. 1102 is based on actual premiums for terrorism insurance that have been paid by non-U.S. air carriers that must purchase such insurance from the private sector. Our estimate also takes into account differences in costs faced by private insurance firms that are not borne by the federal government. While this cost estimate reflects

CBO's best judgment on the basis of available information, costs are a function of inherently unpredictable future terrorist attacks. As such, actual costs could fall anywhere within an extremely broad range.

Intergovernmental and private-sector impact: S. 1102 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Federal Costs: Megan Carroll. Impact on State, Local, and Tribal Governments: Sarah Puro. Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

REGULATORY IMPACT STATEMENT

Because S. 1102 does not create any new programs, the legislation would have no additional regulatory impact, and would result in no additional reporting requirements. The legislation would have no further effect on the number or types of individuals and businesses regulated, the economic impact of such regulation, the personal privacy of affected individuals, or the paperwork required from such individuals and businesses.

SECTION-BY-SECTION ANALYSIS

Section 1. Extension of airline war risk policies and terrorism coverage

This section would amend section 44302(f) of title 49, United States Code, to extend through August 31, 2008, the coverage provided by any war risk insurance policy that DOT has currently issued to U.S. civil aircraft. The Secretary would be authorized to further extend the coverage through December 31, 2008.

This section would also amend 44303(b) of title 49, United States Code, to extend through December 31, 2008, the authority of the Secretary to certify that an air carrier has been a victim of a terrorist act, and thus, not responsible for losses suffered by third parties in excess of \$100,000,000 in total for all claims arising out of such an act. In addition, no punitive damages may be awarded against an air carrier or the Federal Government under this provision, and the Federal Government would be responsible for any liability in amounts that exceed \$100,000,000, for any claims arising as the result of a terrorist act against an air carrier covered under the DOT's policy.

CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, existing law in which no change is proposed is shown in roman):

[TITLE 49—TRANSPORTATION]
[SUBTITLE VII—AVIATION PROGRAMS]
[PART A—AIR COMMERCE AND SAFETY]

SUBPART III—SAFETY

CHAPTER 443—INSURANCE

§ 44302. General authority

(a) **INSURANCE AND REINSURANCE.**—(1) Subject to subsection (c) of this section and section 44305(a) of this title, the Secretary of Transportation may provide insurance and reinsurance against loss or damage arising out of any risk from the operation of an American aircraft or foreign-flag aircraft.

(2) An aircraft may be insured or reinsured for not more than its reasonable value as determined by the Secretary in accordance with reasonable business practices in the commercial aviation insurance industry. Insurance or reinsurance may be provided only when the Secretary decides that the insurance cannot be obtained on reasonable terms from an insurance carrier.

(b) **REIMBURSEMENT OF INSURANCE COST INCREASES.**—

(1) **IN GENERAL.**—The Secretary may reimburse an air carrier for the increase in the cost of insurance, with respect to a premium for coverage ending before October 1, 2002, against loss or damage arising out of any risk from the operation of an American aircraft over the insurance premium that was in effect for a comparable operation during the period beginning September 4, 2001, and ending September 10, 2001, as the Secretary may determine. Such reimbursement is subject to subsections (a)(2), (c), and (d) of this section and to section 44303.

(2) **PAYMENT FROM REVOLVING FUND.**—A reimbursement under this subsection shall be paid from the revolving fund established by section 44307.

(3) **FURTHER CONDITIONS.**—The Secretary may impose such further conditions on insurance for which the increase in premium is subject to reimbursement under this subsection as the Secretary may deem appropriate in the interest of air commerce.

(4) **TERMINATION OF AUTHORITY.**—The authority to reimburse air carriers under this subsection shall expire 180 days after the date of enactment of this paragraph.

(c) **PRESIDENTIAL APPROVAL.**—The Secretary may provide insurance or reinsurance under subsection (a) of this section, or reimburse an air carrier under subsection (b) of this section, only with the approval of the President. The President may approve the insurance or reinsurance or the reimbursement only after deciding that the continued operation of the American aircraft or foreign-flag aircraft to be insured or reinsured is necessary in the interest of air commerce or national security or to carry out the foreign policy of the United States Government.

(d) **CONSULTATION.**—The President may require the Secretary to consult with interested departments, agencies, and instrumental-

ities of the Government before providing insurance or reinsurance or reimbursing an air carrier under this chapter.

(e) **ADDITIONAL INSURANCE.**—With the approval of the Secretary, a person having an insurable interest in an aircraft may insure with other underwriters in an amount that is more than the amount insured with the Secretary. However, the Secretary may not benefit from the additional insurance. This subsection does not prevent the Secretary from making contracts of coinsurance.

(f) **EXTENSION OF POLICIES.**—

(1) **IN GENERAL.**—The Secretary shall extend through [August 31, 2005, and may extend through December 31, 2005,] *August 31, 2008, and shall extend through December 31, 2008,* the termination date of any insurance policy that the Department of Transportation issued to an air carrier under subsection (a) and that is in effect on the date of enactment of this subsection on no less favorable terms to the air carrier than existed on June 19, 2002; except that the Secretary shall amend the insurance policy, subject to such terms and conditions as the Secretary may prescribe, to add coverage for losses or injuries to aircraft hulls, passengers, and crew at the limits carried by air carriers for such losses and injuries as of such date of enactment and at an additional premium comparable to the premium charged for third-party casualty coverage under such policy.

(2) **SPECIAL RULES.**—Notwithstanding paragraph (1)—

(A) in no event shall the total premium paid by the air carrier for the policy, as amended, be more than twice the premium that the air carrier was paying to the Department of Transportation for its third party policy as of June 19, 2002; and

(B) the coverage in such policy shall begin with the first dollar of any covered loss that is incurred.

(g) **AIRCRAFT MANUFACTURERS.**—

(1) **IN GENERAL.**—The Secretary may provide to an aircraft manufacturer insurance for loss or damage resulting from operation of an aircraft by an air carrier and involving war or terrorism.

(2) **AMOUNT.**—Insurance provided by the Secretary under this subsection shall be for loss or damage in excess of the greater of the amount of available primary insurance or \$50,000,000.

(3) **TERMS AND CONDITIONS.**—Insurance provided by the Secretary under this subsection shall be subject to the terms and conditions set forth in this chapter and such other terms and conditions as the Secretary may prescribe.

§ 44303. Coverage

(a) **IN GENERAL.**—The Secretary of Transportation may provide insurance and reinsurance, or reimburse insurance costs, as authorized under section 44302 of this title for the following:

(1) an American aircraft or foreign-flag aircraft engaged in aircraft operations the President decides are necessary in the interest of air commerce or national security or to carry out the foreign policy of the United States Government.

(2) property transported or to be transported on aircraft referred to in clause (1) of this section, including—

(A) shipments by express or registered mail;

(B) property owned by citizens or residents of the United States;

(C) property—

(i) imported to, or exported from, the United States; and

(ii) bought or sold by a citizen or resident of the United States under a contract putting the risk of loss or obligation to provide insurance against risk of loss on the citizen or resident; and

(D) property transported between—

(i) a place in a State or the District of Columbia and a place in a territory or possession of the United States;

(ii) a place in a territory or possession of the United States and a place in another territory or possession of the United States; or

(iii) 2 places in the same territory or possession of the United States.

(3) the personal effects and baggage of officers and members of the crew of an aircraft referred to in clause (1) of this section and of other individuals employed or transported on that aircraft.

(4) officers and members of the crew of an aircraft referred to in clause (1) of this section and other individuals employed or transported on that aircraft against loss of life, injury, or detention.

(5) statutory or contractual obligations or other liabilities, customarily covered by insurance, of an aircraft referred to in clause (1) of this section or of the owner or operator of that aircraft.

(6) loss or damage of an aircraft manufacturer resulting from operation of an aircraft by an air carrier and involving war or terrorism.

(b) AIR CARRIER LIABILITY FOR THIRD PARTY CLAIMS ARISING OUT OF ACTS OF TERRORISM.—For acts of terrorism committed on or to an air carrier during the period beginning on September 22, 2001, and ending on [December 31, 2005,] *December 31, 2008*, the Secretary may certify that the air carrier was a victim of an act of terrorism and in the Secretary's judgment, based on the Secretary's analysis and conclusions regarding the facts and circumstances of each case, shall not be responsible for losses suffered by third parties (as referred to in section 205.5(b)(1) of title 14, Code of Federal Regulations) that exceed \$100,000,000, in the aggregate, for all claims by such parties arising out of such act. If the Secretary so certifies, the air carrier shall not be liable for an amount that exceeds \$100,000,000, in the aggregate, for all claims by such parties arising out of such act, and the Government shall be responsible for any liability above such amount. No punitive damages may be awarded against an air carrier (or the Government taking responsibility for an air carrier under this subsection) under a cause of action arising out of such act. The Secretary may extend the provisions of this subsection to an aircraft manufacturer

(as defined in section 44301) of the aircraft of the air carrier involved.

