

ZUCKERT SCOUTT & RASENBERGER, L.L.P.

ATTORNEYS AT LAW

888 Seventeenth Street, NW, Washington, DC 20006-3309

Telephone [202] 298-8660 Fax [202] 342-0683

RISK MANAGEMENT WHEN AN AIRLINE GOES TO WAR

Airlines Participating In Operation Desert Shield Relied On Insurance Provided By The U.S. Government

By: Malcolm Bengé

The buildup of U.S. military forces in the Persian Gulf, code-named Operation Desert Shield, involved the largest airlift ever of military personnel and equipment. The requirements for Desert Shield far exceeded the military's own airlift resources and civilian carriers were called upon to take up the slack. Where some carriers dared to tread, insurance underwriters refused to follow. Commercial war risk insurance was unavailable for Desert Shield operations, forcing the U.S. Government into the business of providing insurance.

Insurance is available from the U.S. Government under Title XIII of the Federal Aviation Act (49 U.S.C. § 1531, et seq.). Title XIII insurance is intended to address gaps in coverage that result when insurance is not available from commercial underwriters on "reasonable terms and conditions." The need for Title XIII arises from the provisions of the typical war risk insurance policy, which allow for cancellation on short notice.

The immediate problem growing out of the Persian Gulf crisis was the decision in early August by Lloyd's and other underwriters to cancel war risk insurance for carriers operating into Saudi Arabia and Kuwait, pending a review of rates. Although that decision continues to have repercussions industry-wide, it created a particularly difficult situation for carriers participating in the Desert Shield airlift: they would not fly without war risk coverage but were unwilling to pay the extraordinarily high premiums needed to get it, to the extent it was available at all.

To resolve this dilemma, several carriers began pressing for the issuance of Title XIII insurance to cover their Desert Shield operations. By law, Title XIII may be invoked only after (1) a determination by the President that the aircraft operation to be covered by government-provided insurance is "necessary to carry out the foreign policy of the United States" and (2) a determination by the Secretary of Transportation that war risk insurance is not reasonably available from commercial sources (14 C.F.R. § 198.1). With the necessary determinations in hand by mid-August, the U.S. Government was able to activate Title XIII coverage in time for the first flights by civilian carriers in support of Desert Shield.

Title XIII insurance is administered by the Federal Aviation Administration (FAA) and is issued with or without charge. Non-premium insurance is available only for service provided under contract to an agency or department of the U.S. Government (14 C.F.R. § 198.3). The contracting agency must agree to indemnify the FAA against all insured losses. Carriers

operating Desert Shield flights were issued Title XIII insurance on a non-premium basis: all Desert Shield missions operated by civilian carriers were performed pursuant to a contract with the Department of Defense (DOD) and DOD entered into the required indemnity agreement with the FAA.

In order to obtain Title XIII insurance, a carrier must apply to the FAA for coverage on a flight-by-flight basis. The amount of coverage provided is limited to the same amount and the same losses previously covered under the applicant's commercial policies before notice that such insurance would be suspended. Title XIII coverage is not confined to U.S.-registered aircraft; foreign civil aircraft are also eligible for Title XIII insurance if their operation is in furtherance of the foreign policy interests of the U.S. A foreign-registered aircraft flying U.S. citizens out of a war zone, for example, would be a prime candidate for Title XIII insurance, provided the necessary conditions for the issuance of such insurance had been met.

The extension of Title XIII insurance to Desert Shield operations coincided with the U.S. Government's activation of Stage I of the Civil Reserve Air Fleet (CRAF). CRAF is a ready-reserve of U.S. civilian jetliners operated in regular commercial services but subject to Government call-up in times of war or national emergency. On August 17, the U.S. Government activated CRAF aircraft for the first time in the thirty year history of the program. With the commencement of hostilities, the Government activated CRAF Stage II. For the aircraft subject to the CRAF call-up, war risk perils are covered by Title XIII insurance while all other losses are covered by a blanket indemnification provided by the U.S. Government. Not all of the aircraft participating in the Desert Shield airlift were CRAF aircraft; many were provided to the U.S. Government under ad hoc contractual arrangements. Although all aircraft flying Desert Shield missions were eligible for Title XIII insurance, only CRAF aircraft are supposed to benefit from the blanket government indemnification. The U.S. Government has not strictly observed this distinction, and many of the carriers engaged in Desert Shield missions used CRAF and non-CRAF aircraft for the same operations.

The perils covered under Title XIII insurance include loss, injury or damage with respect to aircraft, crew members, passengers, cargo, baggage, and any other liability (including contractual liabilities) customarily covered by aviation insurance. Title XIII insurance is geographically limited in scope to points outside of the U.S.; air transportation within the U.S., even of military personnel or cargo, is not eligible for Title XIII coverage, in keeping with the idea that Title XIII insurance is provided only as necessary to protect the foreign policy interests of the U.S.

Title XIII insurance is not intended to be comprehensive. Even for (non-CRAF) aircraft that performed Desert Shield flights, all perils other than war risks continued to be covered by commercial underwriters. Whether insurance is available under Title XIII and for what types of losses depends on the willingness of commercial underwriters to stay in the market. Although the FAA is authorized to provide any aviation insurance customarily available from commercial sources, its insurance role will expand and contract as tensions in the Persian Gulf intensify or ease.

The interplay between Title XIII and commercial insurance has given rise to difficult questions of coverage and responsibility. At various points in its flight path, an aircraft operating in support of Desert Shield was fully or only partially covered by its commercial insurance policy. Now that the war is over, operators, lessors and the insurance community are struggling to find solutions to the problems posed by shifting coverages.

During the early stages of Desert Shield, a dispute arose as to the insurance coverage for the air transportation of military personnel or equipment within the U.S. Title XIII insurance extends only to that portion of a flight commencing with the last point of departure in the U.S. and ending with the overseas destination. Desert Shield traffic between points in the U.S. is ineligible for Title XIII coverage. However, because that traffic involved the movement of troops and war material, and was bound for the Persian Gulf, commercial underwriters balked at providing insurance for flight segments within the U.S. This quandary was resolved only when commercial insurance was made available up to the point when the aircraft departed the U.S. at which time Title XIII insurance entered into force.

Similar difficulties occurred overseas with aircraft that had completed their Desert Shield missions. At that point, an aircraft was located in the Persian Gulf but was no longer being used for military purposes. There is now general industry agreement that an aircraft operating with Title XIII coverage once again will be fully covered by commercial insurance (subject to availability), upon the resumption of its civilian role. This understanding allowed for commercial insurance coverage of aircraft operating the return segment of a Desert Shield mission, but only for the carriage of civilian traffic. The precise point when commercial war risk insurance reattaches is still subject to interpretation, but logic and convenience would suggest the time of boarding by the first commercial passenger or the loading of the first piece of commercial cargo.

Where one coverage ends and another begins does not necessarily depend on the use of the aircraft or its location. Even an aircraft operating in the Persian Gulf in support of Desert Shield was not totally bereft of commercial insurance. Before hostilities commenced, only AV52 liability insurance had been canceled for Desert Shield operations, while war risk hull insurance had been determined by the Secretary of Transportation to be unavailable on commercially reasonable terms. All other coverages continued in force as written by commercial insurers. Thus, if an aircraft participating in Desert Shield had been destroyed by fire unrelated to any hostilities while operating in the Persian Gulf, the loss value for the aircraft would still have been payable by the commercial underwriter, not by the U.S. Government. Under these circumstances, any loss resulting from multiple sources will undoubtedly produce claims against commercial insurers and the U.S. Government alike.

Another question arising under Title XIII is the amount of coverage available. In no event will the U.S. Government insure an aircraft for an amount greater than that provided under the commercial policies Title XIII is designed to replace. In the case of hull insurance, the amount insured may not exceed the "fair and reasonable value of the aircraft" (50 Fed. Reg. 51332, 51334 (1985)). It is not clear whether the U.S. Government's definition of "fair and reasonable" would extend to every instance of the practice -- common in the industry -- of

insuring aircraft substantially above market value. However, the FAA has acknowledged that in setting the limits of Title XIII coverage, it must be guided by standards other than those set by the market.

Yet another area of uncertainty is coverage under Title XIII of certain contractual liabilities imposed on the operator of an aircraft by a lessor or mortgagee. For example, a lease or security agreement will typically provide for the payment of additional rent or interest if the receipt of insurance proceeds due upon a loss is delayed. Although Title XIII insurance is supposed to provide the same coverage customarily available from commercial sources (and such payments of additional rent or interest are a customary feature of commercial insurance), it is unclear whether the U.S. Government is prepared to insure every loss for which coverage exists under a commercial policy.

At present, concerns about the coverage afforded by Title XIII are based more on speculation than on fact. It is not that the U.S. Government has expressed an unwillingness to insure certain risks covered by commercial underwriters; it is only that there is not a body of experience to draw upon in determining what losses will or will not be reimbursable. Ongoing discussions among the FAA, aircraft operators and the insurance community are helping to reduce the areas of uncertainty and are leading to an industry consensus on the respective roles of Title XIII and commercial insurance.

A carrier applying for Title XIII insurance should be prepared to submit extensive information to the FAA regarding its commercial policies. In order to obtain the maximum extent of coverage under Title XIII, applicants should be as detailed as possible when describing the insurance previously provided by commercial underwriters. If an aircraft is subject to a lease or mortgage, all contractual liabilities insured by commercial sources should be included in the application for Title XIII coverage. Close coordination with an insurance broker is indispensable, not only to keep abreast of the latest developments in the insurance industry but also to confirm that the operator's aircraft are continuously covered by one form of insurance or another.

Title XIII offers civilian carriers a valuable safety net when commercial insurance cannot be obtained on reasonable terms for operations on behalf of the U.S. Government. It is likely to see increasing application as the posture of the U.S. military changes from the stationing of ground forces abroad to a quick-response capability heavily dependent on civilian airlift resources.