

Submission from Johnson Stokes and Master

CIVIL AVIATION (AMENDMENT) BILL 2005 - MATTERS FOR DISCUSSION**A. Purpose**

The purpose of this Memorandum is to provide background information ahead of a meeting scheduled to be held on 15th September at which The Hon. Margaret Ng and The Hon. Ronny Tong Ka-wah, S.C. will attend. The purpose of the meeting is to exchange views on certain issues which arise out of the Civil Aviation (Amendment) Bill 2005 (the “**Amendment Bill**”).

B. Policy considerations - Strict liability under Civil Aviation Ordinance (Cap.448 of the Laws of Hong Kong)**1. Strict Liability - Section 8(2)**

Section 8(2) of the Civil Aviation Ordinance (Cap. 448 of the Laws of Hong Kong) (the “**Ordinance**”) imposes strict liability on the owner of an aircraft for loss or damage caused to persons or property on land or water by that aircraft (unless the loss or damage was caused or contributed to by the person suffering the loss or damage). The owner of an aircraft is therefore liable for loss and damage caused by that aircraft to persons or property on land or water irrespective of whether the owner was at fault in some way (whether deliberately or negligently).

2. Strict Liability - Why?

As a general rule, strict liability is imposed by statute to encourage greater vigilance to prevent a prohibited act. In the context of civil aviation, the imposition of strict liability by Section 8(2) of the Ordinance suggests an intent to ensure that aircraft are maintained at a standard which will not endanger lives and property. A party which falls within the ambit of Section 8 of the Ordinance will be liable without proof of fault.

3. Strict Liability - Scope

Given the consequences of imposing strict liability, it might be reasonable to expect Section 8(2) to carefully specify each person who will bear strict liability. In fact, the position is not entirely clear. Section 8(2) of the Ordinance makes the “owner” of an aircraft subject to strict liability, and Section 8(4) of the Ordinance states that for the purposes of Section 8(2), a person having the management of an aircraft will be deemed to be its “owner”. Thus, in Hong Kong, the following persons bear strict liability for loss or damage caused to persons or property on land or water by an aircraft:

- (a) the owner of the aircraft; and
- (b) the person having the management of the aircraft.

As the Bills Committee has correctly pointed out, it is difficult to ascertain what is meant by the reference to “having the management of the aircraft”.

4. **Strict Liability For Aircraft Owners - Justification?**

It may once have been the case that an airline owned the aircraft which it operated. Nowadays, this is often not the case. Modern aircraft are very expensive and few airlines have surplus cash; thus it is common for airlines to acquire their aircraft by way of an operating lease, or by way of a finance lease:

- (a) **In a typical operating lease** an aircraft lessor leases an aircraft to an airline in much the same way as a car rental company rents a car to a consumer. The aircraft lessor provides the aircraft in an "as is, where is" condition and the airline is responsible for providing crew for the aircraft, fuelling the aircraft, maintaining the aircraft and insuring the aircraft, in each case throughout the term of the lease. The aircraft lessor cedes all control over the daily operation of the aircraft until the airline returns the aircraft to the aircraft lessor at the expiry of the lease term.
- (b) **In a typical finance lease** a bank or financial institution purchases an aircraft and immediately leases the aircraft to the airline on an "as is, where is" basis (in the same manner as a consumer credit/hire purchase transaction). The finance lessor uses the rent paid by the airline to fund repayment of loans used to finance the acquisition of the aircraft (the lease rentals being designed to repay the loans in full). The airline is responsible for providing crew for the aircraft, fuelling the aircraft, maintaining the aircraft and insuring the aircraft, in each case throughout the term of the lease. The financier has no control over the daily operation of the aircraft.

The key difference between an operating lease and a finance lease is that, at the end of the lease term, a finance lessor expects to transfer ownership of the aircraft to the airline. In other respects, the two types of transactions are quite similar. Importantly, as a matter of contract, all risks of operation are passed from the owner of the aircraft to the operator of that aircraft.

In circumstances where the owner of an aircraft has no day-to-day involvement in the operation of an aircraft, the question arises: should the owner be subject to strict liability for loss or damage caused by that aircraft? If not, which party should bear strict liability?

5. **Strict Liability - Who Should Bear Responsibility?**

(a) **Potential Targets**

- (i) *the owner of the aircraft (which might be an aircraft leasing company or a finance lessor)*: The owner of the aircraft may be a special purpose company with no net assets, no involvement in the management of the aircraft and no expertise in the operation of aircraft. Imposing strict liability on such a passive owner seems inappropriate;
- (ii) *the maintenance facilities repairing the aircraft, its engines and components*: Maintenance facilities are at first sight an attractive target

for strict liability; when an aircraft causes loss or damage to persons or property on land or water, it may be due to the maintenance condition of the aircraft. However, the loss or damage might not be maintenance-related at all - it could arise due to bad weather, pilot error or an act of terrorism. In any event, an aircraft is seldom maintained by a single maintenance facility; one party may repair the airframe, another party may repair the engines, and a host of other service providers may repair components installed upon an aircraft. Would the policy objections of the Ordinance be achieved by imposing strict liability upon every maintenance organisation which has worked on an aircraft, its engines or components? This seems inequitable. Maintenance organisations should remain liable for their acts or omissions in tort, but it does not seem reasonable to impose strict liability on each maintenance facility which has worked on an aircraft;

- (iii) *the banks providing debt to the owner of the aircraft*: A bank lending money to an airline to finance the acquisition of an aircraft assesses based upon the financial strength of the airline and the value of the security granted to it. Very few, if any, banks possess detailed knowledge of how to operate an aircraft in a safe manner. It is difficult to envisage policy reasons why a bank should bear strict liability for loss and damage caused by an aircraft, the acquisition of which was financed by the bank; and
- (iv) *the operator of the aircraft*: Strict liability most naturally falls upon the operator of an aircraft (i.e. the relevant airline). It is the operator which selects the crew to fly the aircraft; it is the operator which is responsible for ensuring that the aircraft is properly maintained; and it is the operator which instructs the crew where and when to fly.

(b) The Operator of an Aircraft - the Right Candidate?

This common sense conclusion that an operator of an aircraft should be primarily liable for loss and damage caused by that aircraft is buttressed by other aspects of Hong Kong's civil aviation law and by international practice. For example:

- (i) Section 5 of the Civil Aviation (Insurance) Order (Cap. 448F of the Laws of Hong Kong) makes the operator of an aircraft responsible for insuring the aircraft, and in particular imposes certain minimum requirements with respect to third party liability coverage carried by the operator. This suggests that an aircraft operator, rather than its owner, should be primarily responsible for any liabilities to third parties which might arise from the operation of an aircraft. (In addition, the fact that the operator is obliged to carry third party insurance means that the operator will have sufficient funds to satisfy claims made by persons who suffer loss or damage.)

- (ii) The current movement to update the Rome Convention of 1952 (Convention on Damage Caused By Foreign Aircraft To Third Parties On The Surface) (the "**Rome Convention**") clearly reflects the principle that the operator of an aircraft should bear strict liability for damage caused by that aircraft, rather than the owner of that aircraft.
- (iii) In 2001 an international leasing company carried out a survey of various jurisdictions around the world in which they do business. Of 89 jurisdictions surveyed, only 8 maintained laws that imposed strict liability on owners and/or lessors of aircraft and - of those jurisdictions - 5 have now amended their laws to make them more consistent with the international norm. The remaining 3 are the Dominican Republic, Greece and Hong Kong.

C. The law in Hong Kong

1. Implications

Section 8 of the Ordinance closely resembles Section 40 of the Civil Aviation Act 1949 in the UK. For reasons which we have not been able to ascertain from the records of proceedings of the Hong Kong Legislative Council, the Ordinance does not reflect the amendments adopted into UK law when the Civil Aviation Act 1949 was updated in 1982. The 1982 amendment shifts liability from the owner of an aircraft to the operator of that aircraft if the aircraft has been let for a period exceeding 14 days.

As a consequence, in Hong Kong:

- (a) a passive owner of an aircraft (i.e. a party which owns an aircraft in the capacity of financier or lessor but which is not involved in the day-to-day operation of that aircraft) will bear strict liability for losses caused by that aircraft, even if that owner has never had operational control over the aircraft or its maintenance; and
- (b) an aircraft lessor/financial institution which is the passive owner of an aircraft is exposed to greater owner-related liabilities in Hong Kong than it is in other jurisdictions (e.g. the UK, the US and Australia).

2. The Amendment Bill

It is hoped that the Amendment Bill will bring Hong Kong into line with other jurisdictions by:

- (a) making the operator of an aircraft strictly liable for damage caused by that aircraft;
- (b) exempting "passive owners" of aircraft from strict liability;

- (c) clarifying the concept of "having the management" of an aircraft in Section 8(4) of the Ordinance (this concept is presently undefined) by, if necessary, deleting or replacing Section 8(4) of the Ordinance.

D. Potential issues arising under the proposed Section 8(5) of the Ordinance

The proposed Section 8(5) resembles its equivalent in the UK (i.e. Section 76 of the Civil Aviation Act 1982), save for the addition of sub-paragraph (c), which states that an owner will not be excluded from strict liability if it retains "management" of the relevant aircraft.

1. The concept of "management"

The concept of "management" is not present in the equivalent UK legislation. The introduction of the "management" concept raises the following potential issues:

- (a) As pointed out by the Bills Committee, the concept "management of the aircraft" is not defined. There is a risk that any party which maintains responsibility for finding employment for an aircraft (e.g. an operating lessor, or a third party manager appointed by the owner of the aircraft to find employment for that aircraft) will be considered to have "management" of the aircraft and therefore be subject to strict liability.

e.g. Company A is a special purpose company which owns an aircraft and Company B is a related company which is responsible for managing the employment of that aircraft (i.e. locating airlines to lease the aircraft). Company B identifies an Airline, which agrees to lease the aircraft from Company A for a period of 10 years on terms whereby the Airline is responsible for all maintenance on the aircraft. The lease agreement imposes certain minimum maintenance requirements. After seven years, the aircraft crashes, causing loss of life and damage to property. Should:

- (i) *Company A be strictly liable for the loss of life and damage to property caused by the aircraft crashing?*
 - (ii) *Company B be strictly liable for the loss of life and damage to property caused by the aircraft crashing?*
- (b) It has been suggested that the concept of "management" could extend to a party having responsibility for the "maintenance and repair" of the aircraft. However, it is not clear why this should be the case. Modern aircraft are complicated machines involving many inter-related systems. Those systems may be maintained by a wide variety of service providers. Would all these service providers be considered responsible for the maintenance and repair of the aircraft? Why would the Ordinance seek to impose strict liability upon a wide class of maintenance providers, when the cause of loss or damage on the ground may be adverse weather conditions? Or pilot error? Or an act of terrorism?

- (c) What degree of involvement in the "maintenance and repair" of an aircraft would be necessary for a party to be considered to have the management of that aircraft? For example, would an operating lessor be deemed to be responsible for the management of an aircraft as a consequence of the detailed maintenance and repair provisions which appear in a typical lease agreement? If so, then the purpose of exempting strict liability for such passive owners may be defeated.
- (d) The word "management" is also used in Section 8(4) of the Ordinance. If a person having responsibility for maintenance and repair is deemed to be responsible for the management of an aircraft (as proposed by Section 8(5) of the Ordinance), then that same party will be deemed (by Section 8(4) of the Ordinance) to be an "owner" of the relevant aircraft. Logically, this raises the possibility that a Maintenance, Repair and Overhaul ("MRO") organisation responsible for repair and maintenance of an aircraft (e.g. HAECO) will be deemed to be the "owner" of that aircraft and therefore subject to strict liability. This does not seem consistent with the purpose of the Amendment Bill.

E. Possible solutions

1. Issues to be resolved

The goals of the Amendment Bill might be as follows:

- (a) to ensure that the operator of an aircraft is subject to strict liability under Section 8 of the Ordinance;
- (b) to ensure that the passive owner/financier of an aircraft is exempted from strict liability under Section 8 of the Ordinance;
- (c) to remove the uncertainty associated with the concept of "having the management of" of an aircraft.

Possible drafting solutions for consideration by the Bills Committee are considered below.

2. Proposed Drafting Solutions

- (a) **Repeal Section 8(4) of the Ordinance and adopt the UK equivalent section of Section 8(5)**

Section 8(5) could be modeled directly on the UK equivalent. Adoption of the UK position would suggest that the person to whom the aircraft is demised, let or hired out (i.e. the operator) will be held strictly liable under Section 8 of the Ordinance.

A problem with this approach is that, unless repealed, Section 8(4), with its reference to "having the management of the aircraft" will remain. This concept is uncertain in scope and inconsistent with strict liability legislation in other parts of the world.

- (b) **Substitute the reference to "Owner" in Section 8 with reference to "Operator" - adopting the definition of "Operator" and new Article 10 of the Rome Convention**

Under the Rome Convention (as it is proposed to be updated) the concept "Operator" is defined as follows:

"Operator" means the person who was making use of the aircraft at the time the damage was caused, provided that if control of the navigation of the aircraft was retained by the person from whom the right to make use of the aircraft was derived, whether directly or indirectly, that person shall be considered the operator. A person shall be considered to be making use of an aircraft when he or she is using it personally or when his or her servants or agents are using the aircraft in the course of their employment, whether or not within the scope of their authority.

Section 8(2) could be amended by deleting the word "owner" and inserting the word "operator". This approach would remove strict liability for an aircraft owner and attribute strict liability to the operator of the relevant aircraft.

The proposal to update the Rome Convention also includes the following provisions:

"Neither the owner, lessor or financier retaining title or holding security of an aircraft, not being an operator, nor their servants or agents, shall be liable for damages under this Convention or the law of any State Party."

This language would be helpful to add into Section 8 of the Ordinance. Note in particular the absence of any reference to maintenance and repair arrangements.

- (c) **Add the proposed Article 10 of the Rome Convention to the proposed Section 8(5) of the Ordinance**

Draft Section 8(5) as follows:

"Neither the owner, lessor or financier retaining title or holding security of an aircraft, not being an operator, nor their servants or agents, shall be liable for damages under this Section 8."

A problem with this approach is that Section 8(4), with its reference to "having the management of the aircraft" will remain. This concept is uncertain in scope

and inconsistent with strict liability legislation in other parts of the world. However, the goal of exempting passive owners from strict liability will have been achieved.