



# Aircraft Insurance 2017

Insufficient coverage is among key concerns

text and photography by Kim Rosenlof

Inadequate liability limits can leave aircraft owners personally exposed, according to Jonathan Stern, an aviation attorney with Schnader Harrison Segal & Lewis. Stern spoke during the opening session of the 2017 Aviation Insurance Association (AIA) conference held April 30 to May 2 in San Diego, Calif.

Stern says that unlike airlines, which by law must carry liability insurance with minimums of \$300,000 per passenger and \$20 million per occurrence, general aviation aircraft owners or operators are not

required to carry liability insurance except in a handful of states. He cited a 2015 study by the U.S. Government Accountability Office (GAO) that only 11 states required aircraft owners/operators to carry some variation of liability insurance or financial responsibility. While the states differ in who must carry insurance and how much, the GAO found the typical general aviation policy set at \$1 million limit of liability, sublimited to \$100,000 per passenger.

The problem with low liability limits in aviation is that an accident befalling even a relatively lowly

GA aircraft can generate awards far exceeding the policy limit. Stern cited a recent case in which a jury returned a \$16.6 million verdict following an accident near Frederick Municipal Airport (KFDK) in October 2014. While entering a 45-degree downwind to the airport, a Cirrus SR22 collided with a Robinson R44 Raven that was departing the traffic pattern. The Cirrus pilot deployed the aircraft's ballistic parachute and both occupants walked away from the accident with only minor injuries. The three occupants of the Robinson—a flight instructor, commercial pilot and passenger—were killed. Stern, who served as counsel for the Cirrus pilot\*, noted that a subsequent ruling brought the judgment down to about \$14 million.

“The insured finds him or herself in a situation where there's not enough insurance,” Stern said. “In a case like the one [above] with a \$14 million judgment, the insured may find him or herself in bankruptcy.”

Unfortunately, the options for the general aircraft owner/operator may be limited and out of the insured's control. The 2015 GAO study found that policies with limits higher than the typical \$1 million per occurrence/\$100,000 per passenger were not prevalent in the marketplace.

“Clients who find themselves with an inadequate insurance liability limit have told me that they wanted more insurance but could not get it,” said Stern. “So there is incentive [by the insured] to develop a bad faith claim against the insurer, or recourse against the broker: ‘Why did my broker sell me a policy that only provided a \$1 million limit?’”

Other issues with low-limit policies can arise in situations with multiple claimants where the policy limit is exhausted by settling one claim, leaving nothing left to defend or settle additional claims for the same accident. In many jurisdictions, the first party to settle receives the money, even if it exhausts the limits as long as the settlement is



**Attorney Jonathan Stern warned attendees that the low liability limits in aviation could leave them without enough insurance in the event of a crash.**

reasonable. Stern says that especially in wrongful-death cases, insurers are willing to offer policy limits early in the process to settle the first claim, leaving the insured without coverage or defense on additional claims.

“The majority rule is that the insurer can stop providing a defense after they've exhausted their liability limits through the payment of settlements or judgments that result in the release of one claim or one insured,” Stern said, noting that an insurer would violate its duty of good faith by settling a claim for more than it's worth just to terminate the duty to defend. In some jurisdictions, however, the insurer's duty to defend doesn't end until a judgment has been assessed. “In the case of an insurer that has very low limits, therefore very little at risk, but has to defend the case all the way through trial, it's likely that the insurer will err on the side of doing more defense than it might if its money were at risk [to avoid] a bad-faith claim.”

Stern says that the insurer does not have to accept the first demand within limits or the first reasonable demand. It can choose something in between, looking for the best deal for the insured. The insured does not have to wait for every claimant to file a claim. “So if you have five potential claims, and you're talking to two of them, you can settle one before the other three have even hired counsel,” Stern said. “The insured does not have a

duty to notify those potential claimants about settlements with others, and the non-settling claimants generally have no basis for a bad-faith claim against the insurer.”

For operators flying overseas, U.S. insurance policies may need to be revised depending on specific liability limit minimums and wording required by various countries. For example, the European Union (EU) aircraft insurance liability minimums, which apply to all aircraft (commercial and non-commercial) operating in EU airspace, can be much higher than the limits set on standard U.S. policies. The EU limits are calculated in special drawing rights (SDRs, the currency of the International Monetary Fund) according to the maximum take-off mass (mtom) of the aircraft in kilograms.

Using April 2017 exchange rates for SDRs to USD, the EU minimum insurance on business aircraft ranges from US\$9 million (7 million SDR) for aircraft up to 6,000 kg mtom (Citation Mustang, PC-12), to US\$200 million (150 million SDR) for aircraft of 25,000 to 50,000 kg mtom (G550, Global Express). For all sizes of aircraft, EU per passenger liability minimum is US\$342,000 (250,000 SDR).

### LOCK IN TODAY'S LOW RATES

While reporting on the state of the aviation insurance industry at the AIA Conference, Global Insurance CEO Jack Kuhn said he is starting to see signs of the re-insurance market firming, while underwriting profitability remains challenging in some lines of business.

“There is now ample capacity to meet expected re-insurance demand,” said Kuhn, noting that global reinsurer capital rose to a new high of \$595 billion early this year. “But there is some anecdotal evidence of markets withdrawing or reducing involvement in response to the current environment. The general market remains soft, inspiring broadened terms and requests for multi-year covers

at renewal. We’ve pushed through some coverage through the end of next year, which provides revenue stability for us and certainty of having coverage in place for our insureds.”

According to charts Kuhn provided during his



**Jack Kuhn, CEO of Global Insurance, believes that insurance pricing for the aviation sector may have hit a bottom, and buyers can expect higher premiums.**

presentation, in 2015 the aviation insurance industry collected gross estimated worldwide premiums of \$4.62 billion, with 51 percent paid by general aviation, 34 percent by airlines and 15 percent by aerospace companies. Compare this to historical estimates provided by Allianz Global Corporate and Specialty (AGCS) that indicates worldwide aviation insurance premiums of \$5.85 billion were collected in 2005. While all segments have seen reduced gross premiums collected compared with the numbers from 10 years ago, general aviation has reduced the least in terms of percentage (\$2.36 billion now versus \$2.60 billion then, 9.2 percent less) while airlines have seen a dramatic 27-percent decline in overall premiums collected (\$1.56 billion now versus \$2.15 billion in 2005).

This illustrates one problem that the aviation insurance industry has lamented for the past few years: costs are rising without commensurate increases in gross premiums. With the industry saying it is struggling to return to profitability, insureds might begin to see premiums rise soon.

“On the aviation side, we hope we’ve hit bottom on pricing,” Kuhn said. “We’re starting to see signs that we might be having a shift. The overall aviation insurance market did not see any pricing corrections last year as there were too many markets chasing too few opportunities. Hopefully we will see a hardening mentality this year.”

## INTERNATIONAL OPERATIONS

According to Mitchell Young, senior v-p and eastern general aviation manager at United States Aircraft Insurance Group (USAIG), while many policies provide “worldwide” coverage, operations in some countries may implicitly or explicitly be excluded in the policy language, especially if the policy is being written outside the U.S. If the policy has a Kiln geographic exclusion clause, certain countries in Africa, the Middle East and Asia are often explicitly excluded from coverage. Sometimes just a region of a country, such as “the Far North Region of Cameroon” and “North Sinai Province of Egypt” are excluded. The Kiln clause also implicitly excludes countries through a statement that specifies “any country where the operation of the insured aircraft is in breach of United Nations sanctions.”

However, Young says that there are ways to cover operations in Kiln-excluded countries. “There are exceptions,” said Young. “A primary one is flight

over those countries in international corridors that are recognized by ICAO, and there’s an exclusion for forced landing. Also, any exclusion can be removed before the flight by agreement with the underwriter or slip leader.”

Young identified 14 countries that require their own insurance certificates to conform with special form or wording requirements and seven countries outside the EU that require minimum liability insurance requirements. Some countries, such as Canada, Mexico, Turkey, the United Arab Emirates and Venezuela, have both minimum liability and special wording requirements. Because of the varying requirements from countries around the world, Young recommended that aircraft operators work with international handlers before flying into a new country.

“These handlers, such as Universal and World Fuel, have departments with 12 to 14 people in them that track the insurance and documentation requirements [of various countries] every day,” said Young while showing a map with 50 countries colored in. “This gives you an idea of the breadth of the world that requires some special handling, such as an insurance certificate or territorial exclusion.”

Aircraft registered in the U.S. but conducting operations in certain other countries may encounter some difficulties obtaining insurance—even if the coverage is available—because of sanctions placed on certain countries, regimes and even private individuals by the U.S. Office of Foreign Asset Control (OFAC). This U.S. Treasury Department office can block the transfer of goods and services to sanctioned countries and seize property of sanctioned foreign nationals as soon as it enters the U.S. The sanctions also prohibit U.S. companies from entering into transactions with some 5,500 companies and individuals on the OFAC specially designated nationals (SDN) list.

“OFAC is the most significant restriction that



**Mitchell Young of USAIG addressed the implications of international operations, pointing out that operators should expect numerous exclusions to that coverage.**

U.S. insurance entities—and even some non-U.S. insurance entities—face when providing international insurance coverage,” said Glenn Vallach, vice president and claims attorney at USAIG. “While it doesn’t develop foreign policy, OFAC presides over U.S. sanctions laws. It interprets and provides guidance on the laws for us, and punishes us if we violate the laws...Unfortunately, insurance transactions are so complex that there are many opportunities to do business accidentally with an SDN. Our violations are often unintentional.”

SDNs can be involved in transactions as policyholders, payees, payers, lienholders, beneficiaries, brokers, co-insurers, reinsurers, claimants and even routing or depositing banks. Many of the OFAC programs are strict liability programs, meaning that ignorance is not a defense against a violation. “It doesn’t matter whether the carrier or broker knew the policy holder was an SDN,” said Vallach. “Just entering into a transaction with the SDN is a sanction violation.”

Trade embargoes overseen by the Bureau of Industry and Security (BIS) form another significant part of U.S. sanctions programs, so BIS and OFAC work on a parallel path. “BIS considers a U.S.-registered aircraft flying into a foreign country to be an export in and of itself,” said Vallach. “So theoretically, a U.S. aircraft just flying into Cuba can be a sanction violation.”

But Vallach also noted that recent changes to 15 CFR 740.15 provide a general license exception to export restrictions for the temporary sojourn of aircraft in certain sanctioned countries, among them Cuba now. “If the travel through the sanctioned country is otherwise authorized by OFAC or BIS, then the aircraft can enter the sanctioned country and stay for up to seven consecutive days without a specific license from BIS,” said Vallach. “It also provides a general license for equipment and spare parts permanently used on said aircraft.”

While tourism to Cuba is still prohibited, 12



**USAIG’s Glen Vallach discussed the legal implications of violating sanctions.**

categories of travel are now permitted under the BIS sanctions. No OFAC specific licenses are required for authorized travel, which means the requirement for Part 135 and Part 91 operators to obtain specific licenses for each flight has been dropped, and flight crew can stay with the aircraft for up to seven consecutive days. U.S. insurance companies can now provide hull and liability insurance to aircraft operating within the sanctions limits. However, no policies, claims or reinsurance transactions can be conducted with non-U.S. people facilitating travel by third-country nationals from third countries to Cuba. Vallach said that insurance companies can now also pay claims to Cuban nationals, “where the provision of insurance-related services is authorized by general license.”

### **U.S.-REGISTERED AIRCRAFT OWNED BY FOREIGN ENTITIES**

According to Jeff Towers, v-p and general counsel at TVPX Trust Services, a significant majority of the aircraft owned worldwide are registered with the FAA since the U.S. agency’s rules and processes are “relatively predictable compared to those of some other countries.” While the registration process is straightforward for U.S. citizens, companies and corporations, foreign aircraft owners often need to jump through a few legal hoops to register their

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aircraft in the U.S. While the complex legal entities created by this process allow FAA registration of foreign aircraft, they can create significant insurance difficulties when it comes to making a claim.

“Know your client,” said Vic D’Avanzo, senior v-p of customer care at United States Aviation Underwriters (USAU), during a panel discussion with Towers and two other insurance professionals. D’Avanzo briefly described a recent case in which an aircraft registered by a non-citizen trust generated a claim. “After the [accident] happened and [the claim] got into our office, I did a little research on who was whom. The policy holder was Wells Fargo, which was not the aircraft operator but the trustee. We thought the owner was listed on Provision 20, but that was the lawyer who put the trust together. Nowhere on the policy did we know who our client was. Now we have a fatality, two serious injuries, total loss of the aircraft, and we’re not exactly sure who we’re talking to.”

The FAA allows U.S. citizens, resident aliens and qualifying corporations, partnerships and owner trustees to register aircraft. Corporations and limited-liability companies (LLCs) can register aircraft only if the president and at least two-thirds of the board of directors or managing officers are U.S. citizens. The corporation must be under the actual control of U.S. citizens and at least 75 percent of voting interests must be held or controlled by U.S. citizens. All members of a partnership must be U.S. citizens.

However, the FAA accommodates non-citizen registration of aircraft through three different legal structures: owner trust, voting trust and non-citizen corporations. The trust structures are meant to keep title control of the aircraft in the hands of U.S. citizens through trustee relationships. In both an owner trust and voting trust, the trustee must hold title to the aircraft; an operating agreement allows the trustor to possess and use the aircraft. Non-citizen corporations can register an aircraft with the FAA only if the aircraft is based and primarily used in the U.S.,

## Awards and Recognitions

As part of its annual conference, the AIA recognized several members for their recent or lifelong contributions to the aviation insurance industry. The Pinnacle Award went to Scott Brown, president of W. Brown and Associates Aviation Insurance Services of Irvine, Calif. A second-generation insurance professional, Scott Brown received the Pinnacle Award 24 years after his father, Bill Brown, received the AIA’s first Pinnacle Award in 1993.



**AIA president David Sales, right, awards Todd Fallbacher the CAIP designation.**

The association also recognized six members who earned the Certified Aviation Insurance Professional (CAIP) designation: Bryant Dunn, Todd Fallbacher, Stacey Field, Diana Gaylor, Annette LaRue and Christopher Sheau. In addition, the AIA unveiled a Wells-Chadbourne Award, which grants \$1,000 to the individual with the highest score on the Aviation Course Section of the CAIP exam. To win the Wells-Chadbourne award, the individual must have completed all CAIP courses and be an AIA member in good standing.

Two other \$1,000 education-based awards have been established for AIA members who obtain the highest score on the Aviation Insurance and Risk Management Course (AIRMC). The Distinguished Graduate Award will be awarded to the AIA member with the highest AIRMC score who has been employed more than five years in the aviation insurance industry; the Academic Excellence Award will be awarded to the member with the highest score who has been employed less than five years in the industry.

Nineteen members were also inducted into the AIA’s Eagle Society. □



**L to r: Jeff Towers, Vic D'Avanzo and Ken Forsyth were among the participants in a panel discussion covering U.S.-registered aircraft operated by foreign entities.**

and if the corporation was lawfully organized and doing business under the laws of a U.S. state.

Owner trusts are often used by non-U.S. citizens whose aircraft is based in the U.S., either permanently or temporarily. “You might use an owner trust for the purpose of ferrying an aircraft [currently in the U.S.] to the country it’s going to be permanently registered in,” said Towers. “Also, since the U.S. market is hotter for selling aircraft, foreign owners will often put their aircraft on the N-registry so it’s on par with other aircraft for sale.”

Voting trusts are used by corporations and LLCs in which more than 25 percent of the voting interests on the corporation are held by non-U.S. citizens. A U.S. citizen trustee must hold 75 percent or more of the voting interest in the corporation or LLC that holds title to the aircraft.

However, sometimes these trust arrangements are used simply to register an aircraft that doesn’t even see U.S. soil. “With some of the owner trust arrangements, [the FAA] doesn’t know who’s operating the aircraft or where the maintenance records are,” said Towers. “The FAA admitted the owner trust was a very flexible way to register aircraft—maybe too

flexible...So [in 2013] the agency clarified rules and imposed more responsibilities on the trustees.” Towers indicated that many of these new responsibilities require providing certain maintenance and operation information to the FAA.

The panel recommended that aircraft owners use experienced aviation counsel and advisers when setting up any of these structures, and use recognized aviation trust providers and accepted structures. “We had a large aircraft in Korea that crashed in June last year, and we’re still going through the process of cutting the aircraft up and exporting the useful parts, and disposing of the scrap locally,” said Ken Forsyth, managing director Americas for Crawford Aviation.

“Dealing with the Korean customs authorities has been challenging. You’re never quite sure what the rules are in other countries until these things happen, so you have to flag the potential issues early. That’s what comes from experience—realizing and analyzing what you can do and preparing for the problems in the future.” □

*\*Stern referenced an accident involving a Cirrus SR22 as an example of issues that can arise in litigation due to limited insurance options. The verdict in the case was against another party and was not against the pilot represented by Mr. Stern. AIN regrets this error.*

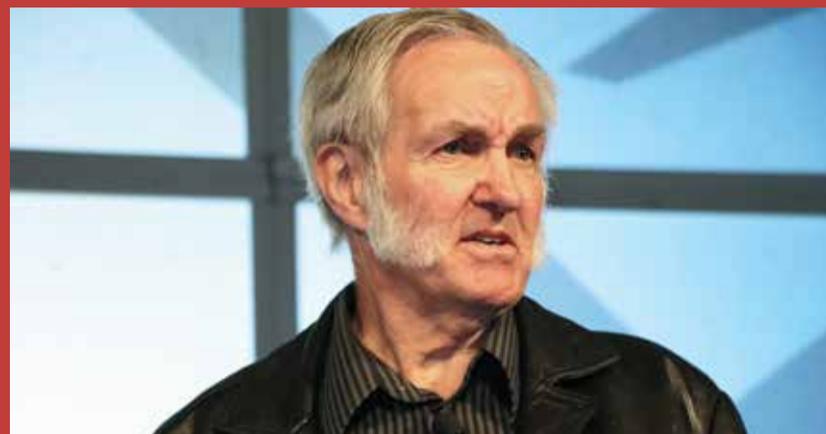
## Burt Rutan's Key to Safety: Question, Never Defend

Aerospace pioneer Burt Rutan, the father of many spectacular aircraft, from *Voyager* (round the world on one tank of gas) to *SpaceShipOne* (first privately built manned spacecraft to reach space and return safely to Earth), spoke candidly to a room of 500 insurance brokers, underwriters and attorneys at the 2017 AIA Annual Conference.

"I was potentially your very best customer," Rutan said during his keynote speech. "I developed 46 different manned research airplanes before I retired in 2011, and I never bought an insurance policy for hull or liability. When you build a research airplane, it's hard to calculate what it's going to cost to repair it because no one has ever repaired one, so we always fixed the things ourselves. And I always felt that the test pilots of our research airplanes were my best friends. If I were going to kill 20 percent of my best friends as the insurance statistics suggested, I don't think I would have been in this business at all... Had I insured every project, not having a claim in 47 projects\*, that's your best customer."

Rutan's firm, Mojave, Calif.-based Scaled Composites, has flight-tested "one new air vehicle per year on average since our founding in 1982," according to its website. Rutan said that his personal perfect safety record\* (and the reason he cites 47 projects but only 46 airplanes) comes from a mantra, "Question, never defend," that was crystallized during a 1988 project for the U.S. government that required general review boards before flight.

"Shortly before we flew the airplane, I stopped the work," said Rutan. "I believed that what [Darpa was] asking me to do would put my perfect safety record in jeopardy. We continually find things on research projects that could be safer and we immediately fix them. But if we convince these generals that the aircraft is safe to fly, and two weeks later I find something out that we would normally just fix, we might just say it's safe enough. I didn't want my people to ever defend safety. I want every one of them—whether it's a shop guy, a test pilot,



**Burt Rutan**

whatever—to always question whether it's safe. In the process of writing a report to some generals to prove to them that it's safe, you are defending, not questioning. So I stopped work."

Rutan lamented the lack of space exploration performed by humans in the past 30 years, noting that from 1961 through 1973 nine different manned space launch systems were developed, but only three have been developed in the subsequent 44 years.

"Less than 10 years from Alan Shepard's [1961] suborbital flight, he was hitting golf balls on the moon," said Rutan. "The next 10 years produced a reusable launch vehicle [the Space Shuttle], Skylab and 4.6 attempts to explore the solar system per year. Then, the next three decades, all of our systems only go where Gagarin and John Glenn went more than 50 years ago... In 2004 there were five manned space flights, and I did three of them in my little space ship with a few dozen people in Mojave (the shuttle was grounded, of course). And the world only launched two interplanetary missions per year during that 30-year time frame. Isn't that kind of embarrassing?"

[\*The loss of Scaled Composites' SpaceShipTwo in 2014 to pilot error, in an accident that claimed the life of one of the two flight crew on board, occurred after Rutan retired in 2011. There have been other losses at Scaled Composites, but no in-flight fatalities while Rutan actively participated in the company.]

—K.R.