Aircraft Insurance: Familiar and Different

By Charles J. Senger and Donald C. Frank

Initially, aircraft insurance policies look familiar, maybe like a typical automobile insurance policy — paragraph upon paragraph of exclusions, exceptions, covenants, warranties, special limitations, and the like with the usual consequences for the various distinctions. Also, both commonly need an annual risk management review of adjustments to premiums and coverage. It all seems familiar and routine, that is, until unexpected twists and turns emerge. Aviation policies, it turns out, sprout from a jungle of diverse policy forms.

This article focuses on the effects of those differences. The differences arise from factors including the limited number of providers; use of specially defined terms like "pilot warranty," "business," or "insured"; application of territorial limits; the requirement of an effective airworthiness certificate; the typically increased number of parties; the inclusion of sublimits; the use of jargon like "hull"; and the slowly growing application of tort law concepts like causality.

Limited market

One general source of differences stems from the small number of companies offering aviation insurance. Unlike areas covered by hundreds of companies, little room exists for negotiation, especially for a single pilot operation. What one company says often holds for the rest. Further, a company typically will provide a quote through one licensed agent, thus restricting the available options even more.

Pilot warranty

Some policy requirements, like minimum licensing requirements, will not surprise attorneys. Others can appear deceptively simple. A good example is the pilot warranty, a typical policy provision commonly misunderstood by pilots, aircraft owners, and even some insurance agents. Even a brief discussion of insurance with a pilot or aircraft owner frequently reveals they believe that if a pilot is specifically named in the pilot warranty or meets the experience and training requirements specified in an open warranty, the pilot is automatically protected by that policy.

While the wording of some policies may extend coverage to all pilots meeting the pilot warranty, aircraft insurance policies commonly word the pilot warranty as a condition of coverage and not a covenant to extend coverage to pilots.

At a Glance

Aircraft insurance policies may look familiar — until unexpected twists and turns emerge. Differences arise from factors including the limited number of providers; use of specially defined terms and jargon; application of territorial limits; the requirement of an effective airworthiness certificate; the typically increased number of parties; the inclusion of sublimits; and the slowly growing application of tort law concepts like causality.

Therefore, if the pilot warranty condition is breached, aircraft policies commonly provide no coverage. The risk of breaching that condition might be obviated by a breach-of-warranty endorsement regarding the outstanding financing balance secured by the aircraft, but such endorsements typically have express subrogation provisions against the insured, applicable if the insurer must pay off a secured lender pursuant to the breach of warranty.

"Business" and "insured"

Examining the pilot warranty is just the start of the close reading required for the whole policy and its endorsements. Surprises lurk in the insuring agreements, definitions, and exclusions — all as modified by the endorsements. Pilots and aircraft owners might be unpleasantly surprised to learn that they are insured for some flights but not for others depending on the purpose or location of the flight. For example, some policies include coverage for pleasure and business flights. Unfortunately, "business" is often defined to mean non-aviation business (such as an attorney flying to a client meeting) and excludes any aircraft operation for which compensation is paid.

Consider, for example, an individual airplane owner who agrees to fly a friend to a vacation home in northern Michigan; in return, the friend pays for all the expenses, including a generous tip for the owner. Unless the flight is operated under an air carrier certificate issued by the Federal Aviation Administration (FAA), this flight is an unauthorized charter that can not only trigger tax consequences[1] and FAA regulatory enforcement,[2] but is unlikely to be covered by the owner's insurance.

Likewise, insuring agreements may extend coverage to all insureds, with the policy containing what appears to be an expansive definition of that term. However, it is not unusual for the definition to have many subparts that restrict it. For example, a pilot specifically named in the pilot warranty may be included in the definition of "insured" but be excluded in a subpart of the definition if conducting a flight evaluation or giving instruction, even if properly licensed and even if they are evaluating the owners of the aircraft.

Territorial limitations

Similar problems can arise from a routine flight that exceeds territorial limitations. This typically arises when coverage limits are specific to the lower 48 states and Canada. Therefore, a flight entering Alaska or a short hop from Florida to the Bahamas would be excluded from coverage.

Airworthiness certificate

An insurance policy requirement that the insured aircraft have an effective FAA airworthiness certificate might seem straightforward. After all, every manufactured aircraft is issued an airworthiness certificate before it is released from the manufacturer, and the certificate has no expiration date.

Unfortunately, problems arise when, for example, various maintenance or inspection requirements are missed, thereby suspending the validity of the airworthiness certificate. Similarly, a standard airworthiness certificate is only effective as long as the aircraft is registered in the United States,[3] and U.S. registration can inadvertently become ineffective in a number of ways, such as the passage of 30 days after the death of the registered owner, loss of corporate U.S. citizenship, or missing the required triennial renewal of the aircraft registration certificate.[4] These are but a few of the many ways the validity of an airworthiness certificate can be unexpectedly negated, potentially voiding insurance coverage.

Number of parties

Like other types of complex commercial policies, differences also arise from the sheer number of parties that may be involved in a typical aviation insurance case — representatives for the aircraft owner, the pilot, other occupants of the aircraft, owners of any property or freight on board, etc. The list then expands to include designers or manufacturers of the engines, airframe, instruments, and electronics along with the individual technicians and shops that maintain, repair, and inspect them. Finally, apart from the aircraft and its occupants, other persons, entities, and property might have suffered damage and need representation in litigation. In the resulting maze of conflicting claims, many may seek to absolve themselves from liability by pooling their considerable resources to pin all responsibility on the pilot. If the pilot's actions violated some provision of the policy, the insurance may well be nullified based on that responsibility.

Sublimits

Even for those covered by a policy, often overlooked policy sublimits may drastically reduce the assumed coverage

amount. For instance, a pilot might obtain a $1 million policy at an attractive price. Unfortunately, that pilot might not notice that it has a sublimit of $100,000 per occupant. If a passenger is injured, only $100,000 is available to cover that liability, not $1 million. The problem looms especially large for less experienced pilots, some renters, and owners of older aircraft who may be unable to obtain so-called "smooth" coverage that applies the full policy amount to any loss.

Hull coverage

Coverage for the hull, a term for the airframe borrowed from maritime insurance, also provides its share of surprises for the uninitiated. Even pilots who satisfy the pilot warranty are not commonly covered for hull losses unless they are an individual owner of the aircraft (and not just the sole owner of a limited liability company that owns the aircraft). In the case of an LLC, the insurer may subrogate against the pilot if there is a hull loss; as a non-owner, the pilot doesn't have an insurable interest in the aircraft. That exposure may be remedied by an endorsement waiving subrogation, but a pilot owning an aircraft through a single-member LLC might not think of doing that or understand that.

Hull insurance limits also have a hidden surprise for the unwary. Aircraft policies are typically sold with a stated value for the aircraft and do not pay whatever the market value is at the time of loss. Consider owners who seek to save money on insurance premiums by specifying a low value for their aircraft, or owners who invest in expensive upgrades without increasing the stated hull value — policies commonly define a total loss as essentially any loss for which the stated value is exceeded by the cost of repair plus the value of salvage, which becomes the insurer's property upon paying for a total loss. Our hapless underinsured owners may find that with even minor damage, the insurer will declare the aircraft a constructive total loss, pay the stated value, and take the slightly damaged aircraft as salvage.

Owners who buy insurance with an excessively high stated value may find themselves just as unhappy as the owners with the low stated value. In that case, the insurer may want to pay for repairing much more damage than the owners want, leaving the owners with an aircraft that has been repaired but has a greatly reduced resale value because it suffered major damage. Unfortunately for the owners, such policies cover repair or loss, but not diminution of market value.

Tort law

One additional difference might develop in future Michigan law. Although aviation insurance policies usually are governed by contract law, one Michigan opinion mentioned the possibility of applying tort law even though the idea was rejected in the case.[5] This possibility stems from the age-old blurring of lines between contract and tort actions. Naturally, one is based on the manifested intentions of the parties and the other on obligations imposed by law.[6] In aviation law, the contrasting views are summarized by Kettles and Sisseli.[7]

Conclusion

Michigan lawyers familiar with other forms of insurance can feel somewhat comfortable with aviation insurance if they keep possible differences clearly in mind. These include jargon, definitions, special limitations, a smaller number of providers, the often-increased complexity of litigation, close federal regulation of all aspects of aviation, and even the small but growing interest in bringing tort analysis to aviation policies. Overall, it makes for a fascinating area of the law ripe for the creative approaches of attorneys, no matter which party they represent. ■

Charles J. Senger, a pilot for more than 50 years, clerked for two appellate judges, practiced corporate law, became a certified flight instructor, holds an amateur extra class radio license, and taught at two law schools. His research has focused on teaching, testing, and learning in both law school and aviation. Retired after more 36 years of teaching, he is now a distinguished professor emeritus of Western Michigan University Cooley Law School.

Donald C. Frank has represented aircraft owners and operators, pilots, and aircraft mechanics since 1981 on a variety of aviation matters including FAA violation enforcement and medical certification. He was the founding chairperson of the SBM Aviation Law Section when it formed in 1992. He has held a pilot's license since 1966 and has FAA commercial pilot, single and multi-engine land, seaplane, flight instructor, and advanced ground instructor licenses.

ENDNOTES

1. Whalen, Dixon & Comazzi, *Leasing Structures and Associated Risks: Avoiding Illegal Charter Operations*, 100 Mich B J 24 (July/Aug 2021), an article in this issue that provides an excellent summary of the subject.
2. A commercial operator of an aircraft must hold an FAA certificate and comply with all requirements of 14 CFR 119.1 *et seq.* and 14 CFR 135.1 *et seq.*
3. 14 CFR 21.181(a).
4. 14 CFR 47.40(a)(3) and 14 CFR 47.41(a).
5. *Kilburn v Union Marine & Gen Ins Co, Ltd*, 326 Mich 115, 119; 40 NW2d 90 (1949).
6. Prosser & Keeton, Torts (5th ed), § 92, pp 655–656.
7. Kettles & Sisseli, *The Causal Connection Question in Aviation Insurance Coverage*, 75 J Air L & Com 829 (2010), available at <https://scholar.smu.edu/cgi/viewcontent.cgi?article=1246&context=jalc> [https://perma.cc/UFN7-SXAY] (site accessed July 4, 2021).