Journal of Air Law and Commerce

Volume 81 | Issue 4 Article 3

2016

Aviation Insurance: Coverage, Claims, and Controversies

Pamela C. Hicks
Hicks Davis Wynn, P.C.

AVIATION INSURANCE: COVERAGE, CLAIMS, AND CONTROVERSIES

PAMELA C. HICKS*

I. INTRODUCTION

FOR MANY YEARS, one of my primary areas of practice has been defending aviation-related claims. At times, I have been directly engaged by a defendant who is self-insured, but more often, I am retained by insurers to defend their insureds. Over the years, in the context of my non-aviation work, I have also litigated fairly in-depth insurance coverage matters on behalf of insurers. My coverage work has expanded my perspective on what insurance issues might come into play during the prosecution or defense of an aviation case and given me a unique perspective on what aviation practitioners should be cognizant of as they navigate through an aviation lawsuit (or any type of claim involving insurance).

There are excellent in-depth treatises[1] on aviation insurance, as well as articles about discrete policy provisions but no general summary of what insurance issues the aviation practitioner might encounter. This article is intended to fill that gap and provide a general overview of some common aviation coverage issues.

II. THE UNIQUE AVIATION INSURANCE MARKET

The risks insured in the aviation insurance market are varied, but some common types of policies and coverage include aircraft manufacturer insurance, air cargo insurance, air charter

* Pam Hicks represents commercial air carriers, general aviation interests, shippers, fixed base operators, airports, and aircraft component part manufacturers in accident litigation, product liabilty, commercial, and cargo claims at both the trial and appellate level. She is a founding shareholder of Hicks Davis Wynn, P.C. The views expressed in this article are those of the author and not of the firm or the firm's clients.

[1] For a detailed text on aviation insurance coverage, see ROD D. MARGO ET AL., MARGO ON AVIATION INSURANCE (4th ed. 2014).

insurance, aerobatic or experimental aircraft insurance, airline insurance, airport or ground handler insurance, crew insurance, lender insurance, fixed base operator insurance, flight training insurance, general aviation pleasure and business insurance, hanger-keepers' liability, rotorcraft insurance, space or satellite insurance, and unmanned aircraft systems insurance.

While general aviation risks and ground-based operations involve some of the same considerations as insurance coverage in other industries, the insurance provided to airliners is a distinctly unique market. In traditional markets, premiums are collected from large volumes of insureds, providing capital to pay for a few losses and earning the insurer a reasonable profit over time. However, "[t]he aviation insurance market has always differed from most other insurance markets in that both the premium base and the customer base are very narrow, with just a small number of insureds."[2] The International Air Transport Association (IATA) has about 230 members, a very small number of potential insured, each with potentially huge exposures.[3] A single insurer will not usually underwrite the entire amount of an airline's overall risk. Instead, "a number of insurers will each underwrite a small percentage of that exposure, thus keeping the exposure for any one insurer within acceptable limits."[4] A recent case discussed such a pool of aviation insurers and the right of the managing agent of the pool to pursue the rights of the entire group.[5]

III. THE INSURANCE POLICY AND THE INSURER'S DUTIES

The components of an aviation insurance policy are generally the same as those of other insurance lines, but the specific exclusions and endorsements are unique to the aviation risk.

In general, a policy is comprised of declarations, the insuring agreement, warranties, exclusions, and endorsements. Some policies expressly incorporate documents outside of the policy, such as the application for insurance, and make them a part of

---

[2] *A Guide to Aviation Insurance*, INT'L UNION OF AEROSPACE INSURERS 1 (Dec. 2012), http://www.oecd.org/daf/fin/insurance/4.DavidGasson-background.pdf [https://perma.cc/8WLV-YQJA].

[3] *Id.*

[4] *Id.*

[5] *See* Glob. Aerospace, Inc. v. Platinum Jet Mgmt., LLC, 488 F. App'x 338, 340 (11th Cir. 2012) (discussing the standing a managing general agent has to bring claims on behalf of the insurance pool for policy breaches by insureds).

the insurance contract. Binders, which are temporary, preliminary contracts of insurance, might be the operative insurance contract if an occurrence resulting in a loss takes place before a policy has incepted or between policy periods.[6]

A. Duties to Defend and Indemnify

When a lawsuit is filed, an insured's first step should be to place all insurance carriers on notice of the claim (or potential claim). An insurer then acknowledges the claim and makes a decision as to whether there is coverage, sometimes with the assistance of coverage counsel. The insurer generally has two distinct and separate duties to its insured: the duty to defend, which requires the retention and payment of defense counsel, and the duty to indemnify, which requires the payment of a judgment for a covered claim.[7] An insurer's duty to defend is broader than its duty to indemnify.[8] Tests for determining whether a duty to defend or indemnify is triggered vary by state and involve fact specific and nuanced inquiries.[9]

In Louisiana, Texas, and many other states, whether an insurer has a duty to defend is determined solely by comparing the allegations against the insured in the complaint with the terms of the policy at issue—the so-called "eight corners" (sometimes "four corners") rule.[10] "If a petition does not allege facts within the scope of coverage, an insurer is not legally required to defend a suit against its insured."[11] However, if there are any facts in the complaint that, if taken as true, support a claim for which coverage is not unambiguously excluded, the insurer must defend the insured.[12] "Assuming all the allegations of the

---

[6] *See, e.g.*, Glob. Aerospace, Inc. v. Arthur J. Gallagher & Co. Ins. Brokers of Cal., Inc., No. S-06-594 LKK/KJM, 2007 WL 1695102, at *6 (E.D. Cal. June 8, 2007).

[7] *See* Am. All. Ins. Co. v. Frito-Lay, Inc., 788 S.W.2d 152, 153 (Tex. App.—Dallas 1990, writ dism'd).

[8] Selective Ins. Co. of Se. v. J.B. Mouton & Sons, Inc., 954 F.2d 1075, 1077 (5th Cir. 1992) (applying Louisiana law).

[9] For a recent analysis of whether an aviation insurer had a duty to defend, see City of Glendale v. Nat'l Union Fire Ins. Co. of Pittsburgh, No. CV-12-380-PHX-BSB, 2013 WL 1296418 (D. Ariz. Mar. 29, 2013).

[10] *See* Cont'l Cas. Co. v. Smith, 243 F. Supp. 2d 576, 580 (E.D. La. 2003) (applying Louisiana law); *see also* Am. Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842, 847–48 (Tex. 1994).

[11] *Garcia*, 876 S.W.2d at 848.

[12] *In re* Complaint of Stone Petroleum Corp., 961 F.2d 90, 91 (5th Cir. 1992) (applying Louisiana law); Me. Bonding & Cas. Co. v. Douglas Dynamics, Inc., 594 A.2d 1079, 1081 (Me. 1991) (noting that under Maine law, the insurer must de-

petition are true, the insurer must defend, regardless of the outcome of the suit, if there would be both (1) coverage under the policy and (2) liability to the plaintiff."[13]

However, a number of other jurisdictions permit extrinsic evidence to be considered when determining if there is a duty to defend. In other words, the court will go beyond the eight corners of the policy and complaint to examine the "true facts" to determine the duty to defend.[14] For example, in Iowa, the "[s]cope of inquiry [for the duty to defend] . . . [includes] the pleadings of the injured party and any other admissible and relevant facts in the record."[15]

The duty to indemnify is generally narrower than the duty to defend.[16] This duty is triggered by the actual facts establishing liability in the underlying suit.[17] In the aviation context, the dichotomy between the broader duty to defend and the more limited duty to indemnify is illustrated in *Oxford Aviation, Inc. v.*

---

fend so long as the claims in the complaint create even a remote possibility of coverage).

[13] Hardy v. Hartford Ins. Co., 236 F.3d 287, 290 (5th Cir. 2001) (applying Louisiana law).

[14] One commentator has stated that as many as thirty-five states allow the consideration of some form of extrinsic evidence to ascertain whether there is a duty to defend. *See* Randy J. Maniloff, *The "True Facts" Exception To The Four Corners-Duty To Defend Rule*, LexisNexis Legal Newsroom (Apr. 14, 2014, 1:33 PM), https://www.lexisnexis.com/legalnewsroom/insurance/b/badfaithdutydefend/archive/2014/04/14/the-true-facts-exception-to-the-four-corners-duty-to-defend-rule.aspx?Redirected=true [https://perma.cc/H2QZ-53NY].

[15] *Id.* (citing Talen v. Emp'rs Mut. Cas. Co., 703 N.W.2d 395, 406 (Iowa 2005)); *see* Am. Bumper & Mfg. Co. v. Hartford Fire Ins. Co., 550 N.W.2d 475, 481 (Mich. 1996) ("The insurer has the duty to look behind the third party's allegations to analyze whether coverage is possible."); Garvis v. Emp'rs Mut. Cas. Co., 497 N.W.2d 254, 258 (Minn. 1993) (stating that the determination of the duty to defend includes consideration of facts of which the insurer is "aware"); Farmland Mut. Ins. Co. v. Scruggs, 886 So. 2d 714, 719 n.2 (Miss. 2004) (holding that in determining whether an insurer has a duty to defend, an insurer may consider those "true facts [that] are inconsistent with the complaint" brought to the insurer's attention by the insured); Peterson v. Ohio Cas. Grp., 724 N.W.2d 765, 773–74 (Neb. 2006) (finding that a duty to defend exists where the "actual facts" reveal such a duty exists); Am. Gen. Fire & Cas. Co. v. Progressive Cas. Co., 799 P.2d 1113, 1116 (N.M. 1990) ("The duty of an insurer to defend arises from the allegations on the face of the complaint or from the known but unpleaded factual basis of the claim . . . ."); State Farm Fire & Cas. Co. v. Harbert, 741 N.W.2d 228, 234 (S.D. 2007) ("[T]he issue of whether an insurer has a duty to defend is determined by . . . 'other evidence of record.'").

[16] *But see* D.R. Horton-Tex., Ltd. v. Markel Int'l Ins. Co., Ltd., 300 S.W.3d 740, 741 (Tex. 2009).

[17] Heyden Newport Chem. Corp. v. S. Gen. Ins. Co., 387 S.W.2d 22, 25 (Tex. 1965).

Global Aerospace, Inc.[18] In the underlying suit, a customer sued a repair station for breach of contract, breach of warranty, and other Maine state law claims.[19] The complaint alleged that "one of the plane's side windows cracked during the flight home [from the repair station] due to Oxford's 'negligence and faulty performance.'"[20] The insuring agreement in Oxford's Commercial General Liability (CGL) policy stated that it applied to claims for "bodily injury or property damage . . . resulting from your aviation operations" but applied "only if the injury or damage 'is caused by an occurrence and takes place in the coverage territory.'"[21] Property damage was defined to include "[p]hysical injury to tangible property, including all resulting loss of use of that property," and an occurrence was defined as "an accident . . . ."[22] The CGL policy's exclusions included several "business risk" exclusions, which were intended to leave coverage for faulty work to other policies, such as professional liability policies.[23]

Oxford asked the insurer to defend the lawsuit filed by its customer.[24] The insurer disclaimed both coverage and a duty to defend.[25] A declaratory judgement action followed.[26] Stretching the allegations in the complaint to their extreme, the court determined that the cracked window could have been a "'particular part' of property 'on' which Oxford performed work" because an invoice attached to the complaint mentioned the use of Proseal® on a window that was not furnished or installed by Oxford.[27]

The court recognized that if the customer proved its case against Oxford:

> It seems unlikely that there will be much, if any, indemnification since most of the claimed injuries appear likely to be covered by exclusions. But the duty to defend is triggered by any realistic possibility of any damage that might be within coverage and

---

[18] 680 F.3d 85 (1st Cir. 2012).

[19] *Id.* at 86–87.

[20] *Id.* at 87.

[21] *Id.* at 88.

[22] *Id.*

[23] *Id.* at 89.

[24] *Id.* at 87.

[25] *Id.*

[26] *Id.*

[27] *Id.* at 90.

> outside the exclusions and the damaged window creates that prospect.[28]

Thus, the court held that the insurer had a duty to defend Oxford.[29] However, the court handily rejected Oxford's bad faith claim against the insurer because the "potential for coverage here is a close call" requiring a "close parsing to preserve the possibility" of the duty to defend.[30]

Another recent case discussing the scope of coverage in aviation related policies is *XL Specialty Insurance Co. v. Progressive Casualty Insurance Co.*,[31] decided by the Ninth Circuit. At issue was whether a "policy provid[ing] coverage for any accident 'arising out of the ownership, maintenance or use of the aircraft'" was triggered when a fuel truck was involved in a fatal accident with a passenger vehicle while en route to refuel the helicopter.[32] Applying Montana law, the court determined that although the helicopter was "not involved in the accident itself, [it] was 'a prime accessory, without which the injury-producing incident' . . . would not have occurred."[33] However, the court found that the helicopter's insurer had no obligation to make an equitable contribution toward a settlement because the claim had not been tendered from the insured to the insurer.[34]

IV. THE FORTUITY REQUIREMENT

Since the very basis of insurance is to protect against accidental losses rather than intentional acts or breaches of contract, it should be axiomatic that an insurance policy cannot cover losses that are not fortuitous. Losses that the insured knew about, or should have known about, at the time it purchased a policy are not covered.[35] These concepts are generally known as the fortuity doctrine, the loss in progress, or the known-loss rule.[36]

---

[28] *Id.* at 92.

[29] *Id.*

[30] *Id.*

[31] 411 F. App'x 78 (9th Cir. 2011).

[32] *Id.* at 80.

[33] *Id.*

[34] *Id.* at 81; *cf.* Nw. Airlines, Inc. v. Prof'l. Aircraft Line Serv., 776 F.3d 575, 582 (8th Cir. 2015) (holding that the airline's notice of suit to the insurer of the maintenance company whose actions were responsible for the claim was sufficient to place the carrier on notice of a claim).

[35] Scottsdale Ins. Co. v. Travis, 68 S.W.3d 72, 75 (Tex. App.—Dallas 2001, pet. denied).

[36] Chu v. Canadian Indem. Co., 274 Cal. Rptr. 20, 25 (Cal. Ct. App. 1990) ("The concept of 'fortuity' is basic to insurance law. . . . Insurance protects

As explained by the Texas Supreme Court, "it is contrary to public policy for an insurance company, the business of which is affected with a public interest, knowingly to assume the burden of a loss that occurred prior to making the contract"; accordingly, "an agent has no authority to issue a policy to cover a known loss."[37] A "known loss" is "a loss the insured knew had occurred prior to making the insurance contract."[38] A "'loss in progress' occurs when the insured is, or should be, aware of an ongoing progressive loss at the time the policy is purchased."[39] Under the doctrine, "[i]nsurance coverage is precluded where the insured is or should be aware of an ongoing progressive or known loss at the time the policy is purchased"—not at the time of the retroactive date in the policy.[40] When there are many insureds, at least one court has held that fortuity is to be evaluated from the insured's joint perspective, such that if one insured knows of a loss, all insureds are precluded from obtaining indemnity under the policy.[41]

Notably, application of the doctrine "does not hinge on whether the insured knew a particular act was wrongful. Rather, it hinges on whether the insured knew before the inception of coverage that an act—knowingly wrongful or otherwise—re-

---

against risks of loss, not certainties of loss."); Two Pesos, Inc. v. Gulf Ins. Co., 901 S.W.2d 495, 501 (Tex. App.—Houston [14th Dist.] 1995, no writ) (explaining that the fortuity doctrine negates a duty to defend or indemnify "where the insured is, or should be, aware of an ongoing progressive loss or known loss at the time the policy is purchased"); *see* RLI Ins. Co. v. Maxxon Sw., Inc., 265 F. Supp. 2d 727, 730 (N.D. Tex. 2003), *aff'd sub nom.*, 108 F. App'x 194 (5th Cir. 2004).

[37] Burch v. Commonwealth Cty. Mut. Ins. Co., 450 S.W.2d 838, 840–41 (Tex. 1970); *see Two Pesos*, 901 S.W.2d at 501–02 (noting that "Texas has long recognized that it is contrary to public policy for an insurance company knowingly to assume a loss occurring prior to its contract" because "[g]enerally, fortuity is an inherent requirement of all risk insurance policies"); see also Mason Drug Co., Inc. v. Harris, 597 F.2d 886, 887 (5th Cir. 1979) (recognizing the "'loss-in-progress' principle" as "standard insurance law").

[38] *Scottsdale*, 68 S.W.3d at 75.

[39] *Id.*

[40] *Id.*; *see Burch*, 450 S.W.2d at 840–41 (noting that "recovery may be had on a policy antedated to include the time at which a loss occurred provided neither the applicant nor the insurer knew of the loss when the contract was made"); *see also* Great Sw. Fire Ins. Co. v. Watt Indus., Inc., 280 Cal. Rptr. 249, 255 (Cal. Ct. App. 1991) (noting that "[a]s long as the insured has no knowledge of a potential claim at the time the policy is purchased, no argument can be made that the risk cannot be insured against").

[41] Fleet Bus. Credit, L.L.C. v. Glob. Aerospace Underwriting Managers Ltd., 646 F. Supp. 2d 473, 479 (S.D.N.Y. 2009) (relying on Cross Liability Provision that specifically exempted the hull and spare parts coverage at issue in the lawsuit).

sulted in a loss."[42] Accordingly, the "loss" triggering the doctrine takes places when the injury occurred—not when a court later adjudicates damages resulting from that injury.[43]

Courts in California recognize fortuity as a "basic insurance concept" because "[i]nsurance protects against risks of [l]oss, not certainties of loss."[44] The California legislature codified the concept of fortuity in the state insurance code. Section 22 of the state insurance code states that "[i]nsurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event."[45] Section 3517 of the state civil code further recognizes that "no one can take advantage of his own wrong."[46] Accordingly, courts in California have found that it is "contrary to public policy to permit a wrongdoer . . . to retain the benefit of defense costs . . . to defend against a known injury."[47] Thus, a plaintiff seeking insurance coverage for a loss must show that the claimed loss was fortuitous.[48]

Under New York law, a "fortuitous event" means "any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party."[49] The burden of proof is on the insured to prove that a loss is fortuitous and within coverage.[50]

In *Fleet Business Credit v. Global Aerospace Underwriting Managers*, the Southern District of New York (and on appeal, the Second Circuit) considered the fortuity doctrine in the context of an

---

[42] Warrantech Corp. v. Steadfast Ins. Co., 210 S.W.3d 760, 768 (Tex. App.—Fort Worth 2006, pet. denied); *see* Hartford Accident & Indem. Co. v. Emp'rs Ins. of Wausau, No. 847212, 1995 WL 870851, at *14 (Cal. Super. Ct. May 26, 1995) ("California courts have applied the 'known loss' rule to deny coverage for damages to third parties where the insured knew of the damage prior to the inception of the insurance policy").

[43] Franklin v. Fugro-McClelland (Sw.), Inc., 16 F. Supp. 2d 732, 736 (S.D. Tex. 1997).

[44] Upper Deck Co. v. Endurance Am. Specialty Ins. Co., No. 10CV1032 JM(WMC), 2011 WL 6396413, at *6 (S.D. Cal. Dec. 15, 2011) (citing Chu v. Canadian Indem. Co., 274 Cal. Rptr. 20, 25 (Cal. Ct. App. 1990)).

[45] CAL. INS. CODE § 22 (West 2016).

[46] CAL. CIV. CODE § 3517 (West 2016).

[47] *Upper Deck*, 2011 WL 6396413, at *7.

[48] Fleet Bus. Credit, L.L.C. v. Glob. Aerospace Underwriting Managers Ltd., 812 F. Supp. 2d 342 (S.D.N.Y. 2011), *aff'd sub nom.*, Highland Capital Mgmt., L.P. v. Glob. Aerospace Underwriting Managers Ltd., 488 F. App'x 473 (2d Cir. 2012) (applying New York law).

[49] N.Y. INS. LAW § 1101(a)(2) (McKinney 2015).

[50] *In re* Balfour MacLaine Int'l. Ltd., 85 F.3d 68, 77–78 (2d. Cir. 1996) (citations omitted).

"all risk" policy covering aircraft and engine parts.[51] The insured airline was cash strapped and "spiral[ing] toward bankruptcy" at the time of the loss.[52] Unable to pay repair bills or obtain credit, the airline had no inventory of spare parts.[53] To keep some of its aircraft operational, several parts had been stripped from the insured aircraft to be used on other aircraft in the fleet.[54] Eventually, a bankruptcy trustee put an end to the scavenging, but not before a Boeing 747-100 airframe and two Pratt & Whitney JT9 engines went missing.[55] The financing companies, who were insured under the policy, made a claim for the lost equipment to the insurer.[56] The insurer declined to provide coverage for the robbed parts, and the insured filed suit.[57]

Evidence presented at trial established that the airline "had a history of reliance on a process known as 'robbing' in which it removed operational parts from aircraft on the ground for use in other aircraft."[58] The court noted that the creditors of the airline were "well aware of [its] practice of robbing," even complaining of the practice to the Bankruptcy Court.[59] The court held that the intentional misconduct of the insured airline was not fortuitous, and precluded coverage for the co-insured lenders.[60]

On appeal, the Second Circuit focused on the creditors' argument that they were "innocent coinsured[s]" and that they "reasonably expected that their interests in the property were covered by the policy despite the independent misconduct of their coinsured" airline.[61] Recognizing that the parties to the insurance contract could vary the application of the innocent coinsured doctrine by the language of the policy, the court affirmed, finding that the "policy covered only those losses that were accidental from the perspective of all insureds, which the claimed losses were not."[62]

---

[51] *Fleet Bus. Credit*, 812 F. Supp. 2d at 354–55.

[52] *Highland Capital Mgmt.*, 488 Fed. App'x at 475.

[53] *Fleet Bus. Credit*, 812 F. Supp. 2d at 348.

[54] *Id.* at 347–48.

[55] *Id.* at 344–47.

[56] *Id.* at 344.

[57] *Id.*

[58] *Id.* at 347.

[59] *Id.* at 349.

[60] *Id.* at 357.

[61] Highland Capital Mgmt., L.P. v. Glob. Aerospace Underwriting Managers Ltd., 488 F. App'x 473, 475 (2d Cir. 2012).

[62] *Id.* at 476.

V. INSURING FOR PUNITIVE DAMAGES

Whether insurance covers awards of punitive or exemplary damages varies both by the language in each insurance policy and by the applicable state law. In *Fairfield Insurance Co. v. Stephens Martin Paving, LP*,[63] the Texas Supreme Court responded to a certified question from the Fifth Circuit as to whether "Texas public policy prohibit[s] a liability insurance provider from indemnifying an award for punitive damages imposed on its insured because of gross negligence?"[64] The court held that "[t]he Legislature's expressed intent is that Texas public policy does not prohibit insurance coverage for claims of gross negligence in this context."[65] Importantly, the insurance policy at issue was a worker's compensation policy, and the court secondarily held that "the public policy of Texas does not prohibit insurance coverage of exemplary damages for gross negligence *in the workers' compensation context*."[66] The court in *Fairfield* did not discuss the word "accident" or its definition under Texas law but interpreted Texas public policy. Thus, outside of the workers' compensation context, the question remains an open one under Texas law.[67]

Fairfield is helpful for providing guidance as to the insurability of punitive damages outside of Texas because, in its opinion, the Texas Supreme Court discussed the issue of whether insuring for punitive damages is against public policy in nearly every state.[68] Twenty-five states have generally determined that public policy does not prohibit insurance coverage for punitive damages, eight states prohibit coverage for such damages, seven permit coverage, but only when the insured's liability is vicarious, and three states permit coverage in the context of uninsured motorists.[69] In contrast, two states prohibit such coverage.[70] Thus, a good starting point for answering the questions of

---

[63] 246 S.W.3d 653 (Tex. 2008).

[64] *Id.* at 654.

[65] *Id.* at 660.

[66] *Id.* at 670 (emphasis added).

[67] *See* Liberty Ins. Corp. v. Dixie Elec., LLC., 101 F. Supp. 3d 575, 583 (N.D. Tex. 2015), *aff'd sub nom.*, No. 15-10279, 2015 WL 9145494 (5th Cir. Dec. 16, 2015).

[68] The court noted that Nebraska prohibits the imposition of punitive damages. *Fairfield Ins. Co.*, 246 S.W.3d at 660–62.

[69] *Id.*

[70] *Id.* at 661–62.

whether punitive damages are insurable is to review the Texas Supreme Court's discussion in *Fairfield*.[71]

VI. LOSS-PAYEE CLAUSES

A loss-payee clause generally provides that the proceeds of an insurance policy are to be first paid to a designated loss-payee (typically a lender) rather than to the named insured. If the loss-payee clause is "open" or "simple" it provides that, if an insured loss occurs, the proceeds first go to the lender.[72] The lender's rights are no greater than those of the named insured.[73] In contrast, a "standard" or "union" loss-payee clause results in additional separate obligations owed to the lender.[74] If the policy does not provide coverage because of the named insured's actions or neglect, the lender is protected.[75]

In *Union Planters National Bank v. American Home Assurance*, the named insured cancelled coverage for one of many aircraft insured under the policy.[76] Later, that aircraft was seized by the U.S. government as an instrument of drug trafficking.[77] The loss-payee endorsement provided that the lender was entitled to thirty days' notice prior to cancellation of the policy and also stated that the insurance would not be invalidated by any act of the named insured or change in ownership of the aircraft except the "conversion, embezzlement[,] or secretion" of the named insured.[78] The lender was not provided notice that the

---

[71] *Id.* at 688 (Hecht, J., concurring) (summarizing, "Finally, though Texas'[s] public policy is its own, it is formed[ ] not in a vacuum, but in awareness of the law of other American jurisdictions. That law is, of course, heavily influenced by the jurisdiction's view of punitive damages. The cases defy easy categorization, but it appears that: [nineteen] states generally permit coverage of punitive damages; [eight] states would permit coverage of punitive damages for grossly negligent conduct, but not for more serious conduct; [eleven] states would permit coverage of punitive damages for vicariously-assessed liability, but not directly-assessed liability; [seven] states generally prohibit an insured from indemnifying himself against punitive damages; and the remainder have silent, unclear, or otherwise inapplicable law. States may fall into more than one category." (footnotes omitted)).

[72] Union Planters Nat. Bank v. Am. Home Assurance Co., No. W2001-01124-COA-R3-C, 2002 WL 1308344, at *4 (Tenn. Ct. App. Mar. 18, 2002).

[73] *Id.* at *4; *see* STEVEN PLITT ET AL., COUCH ON INSURANCE § 65:32 (3d ed. 1995).

[74] *Union Planters*, 2002 WL 1308344, at *4.

[75] *Id.*

[76] *Id.* at *2.

[77] *Id.*

[78] *Id.* at *5.

insurance coverage for the seized aircraft had been cancelled for more than three months after cancellation.[79]

The lender sought coverage under the loss-payee endorsement. The insurer argued that the thirty days' notice provision applied only in the event the entire policy was cancelled.[80] Since other aircraft were still insured, it was inapplicable.[81] The court disagreed, noting the purpose of the notice provision was to permit insureds to obtain alternate coverage in the event of a cancellation, and found the insurer's interpretation of the notice provision to be unreasonable.[82]

The court also found that the owner's failure to keep the aircraft hangered and to operate it in a manner consistent with the insurance policy, which were breaches of the warranty provisions of the policy, did not impact the lender's rights to coverage unless the bank knew of the breaches.[83]

In *St. Paul Fire & Marine Ins. Co. v. Luke Ready Air, LLC*,[84] the owner of a King Air 200 was "conned . . . into turning over the Aircraft" to an individual representing himself as an agent of the government of Guadalajara, Mexico. The "agent" presented the owner with a "Licitation Order" and wired $100,000 to a broker representing the owner.[85] Believing, incorrectly, that the remainder of the aircraft's purchase price would be wired to him, the aircraft was turned over to the "agent."[86] The broker never received the balance of the purchase price, and the "agent" disappeared, along with the King Air.[87] The owner's lender was named as a loss-payee on the aircraft insurance policy.[88] Both the lender and the aircraft owner made a claim for the loss under the policy.[89]

The policy contained the following exclusion: "We will not make pay for the loss or damage caused by or resulting from any of the following: . . . Wrongful 'conversion' . . . of the 'covered aircraft.' . . . Voluntary parting with any property by you or any-

---

[79] *Id.* at *2.
[80] *Id.* at *5.
[81] *Id.*
[82] *Id.* at *6.
[83] *Id.* at *7.
[84] 880 F. Supp. 2d 1299 (S.D. Fla. 2012).
[85] *Id.* at 1302–03.
[86] *Id.* at 1302.
[87] *Id.*
[88] *Id.*
[89] *Id.* at 1303.

one else to whom you have entrusted the property if induced to do so by any fraudulent scheme, device or false pretense."[90]

The policy also contained the following endorsement:

> b. Coverage under the Finance Endorsement
>
> The Finance Endorsement, amongst other things, adds the following condition to the Aircraft policy:
>
> The coverage provided by this policy to [Legacy Bank] will not be invalidated by any act or omission of any other person or organization [that] results in a breach of any term or condition of this policy, provided that [Legacy Bank] has not caused, contributed to, or knowingly condoned[ ] the act or omission.[91]

The lender argued that the endorsement should be read to preclude the application of the exclusions to its claims.[92] The court disagreed, acknowledging that while the bank's claims do not depend on whether the aircraft owner's loss was covered, the loss still must be within the policy's coverage and not subject to exclusions.[93]

VII. CHOICE OF LAW

In the event of a dispute between insured and insurer, which law is applicable to the dispute? Traditionally, aviation insurance policies did not include choice of law provisions.[94] When a policy is silent, what law controls how the insurance contract is interpreted? Texas and a number of other states apply the "most significant relationship" test from the Restatement (Second) of Conflicts when deciding choice of law questions.[95] Section 6 lists these general factors for a court to consider:

(a) the needs of the interstate and international systems,
(b) the relevant policies of the forum,
(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

---

[90] *Id.* at 1307.

[91] *Id.* at 1308 (alteration in original).

[92] *Id.* at 1309.

[93] *Id.*

[94] At least one commentator has observed that there is a trend to include choice of law and forum selection clauses in commercial aviation policies. *See* Katherine B. Posner, *The Unique Role of Aviation Insurance Counsel*, ASPATORE, at *2 (2011), 2011 WL 970668.

[95] *See* Pennzoil-Quaker State Co. v. Am. Int'l Specialty Lines Ins. Co., 653 F. Supp. 2d 690, 702 (S.D. Tex. 2009).

(d) the protection of justified expectations,
(e) the basic policies underlying the particular field of law,
(f) certainty, predictability and uniformity of result, and
(g) ease in the determination and application of the law to be applied.[96]

When determining a breach of contract dispute, Section 188 lists additional factors for a court to consider:

(a) the place of contracting,
(b) the place of negotiation of the contract,
(c) the place of performance,
(d) the location of the subject matter of the contract, and
(e) the domicile, residence, nationality, place of incorporation and place of business of the parties.[97]

The relevant inquiry in a case involving the construction and application of an insurance policy is the contact between the state and the insurance dispute—not the underlying litigation.[98] Courts evaluate the contacts based on their relative importance to the particular issue, and they assign them varying weights to protect the expectations of the parties.[99]

Assume that an insurer is a Delaware corporation with its principal place of business in Massachusetts and that it issued a policy to a Delaware corporation with its principal place of business in California to cover claims brought against the insured within the United States and elsewhere in the world.

A court following the Restatement's choice of law analysis would likely give the place of contracting and negotiation greater weight if the evidence shows that both occurred in California. The place of contracting is the place where "the last act necessary to give the contract binding effect" occurred.[100] If the evidence shows that the policy was contracted, negotiated, and delivered to the insured in California, a Texas court would likely apply California law to protect the "justified expectations" of the parties and to foster "certainty, predictability and uniformity of

---

[96] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2) (AM. LAW INST. 1971).

[97] *Id.* § 188(2). Article 21.42 of the Texas Insurance Code contains a statutory choice-of-law directive for insurance disputes, but is applicable only when the insureds seeking defense and indemnity are "citizen[s]" or "inhabitant[s]" of Texas. TEX. INS. CODE ANN. art. 21.42 (West 2015).

[98] *Pennzoil-Quaker*, 653 F. Supp. 2d at 702–03.

[99] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) cmt. b (AM. LAW INST. 1971).

[100] *Id.* § 188(2) cmt. e.

result" pursuant to the principles of Section 6.[101] For instance, one Texas court applied Mississippi law to a dispute, even though the majority of the insured property was located in Texas, because the policy had been contracted and largely negotiated in Mississippi, it had been delivered in Mississippi, and premiums had been paid out of a business office in Mississippi.[102] However, if the evidence shows that the parties contracted and negotiated from offices in different states, a court will likely give those factors little weight.[103]

A court deciding a choice of law issue in a policy covering commercial aviation risks would likely give the place of performance and the subject matter of the contract little weight, if any, because the policy provided national coverage in every state. The place of performance and the location of the subject matter of the contract are determinative only when insurance policies cover a localized risk.[104] Instead, where, as in the aviation context, the policy covers risks located in multiple states, the location of the risk is insignificant.[105]

Accordingly, the residence of the insured would likely become the determinative factor in the choice of law analysis. As explained by one court, "the most logical way to meet the parties' justified expectations when a policy covers property in multiple states is to apply the law of the insured's state of incorporation or principal place of business."[106]

In contrast, when the risk insured is for a general aviation aircraft, operated primarily in a single state, a court might give more weight to where the insured property is located. For exam-

---

[101] *See, e.g.,* TV-3, Inc. v. Royal Ins. Co. of Am., 28 F. Supp. 2d 407, 415 (E.D. Tex. 1998).

[102] *Id.* at 419–20.

[103] *See* Sonat Expl. Co. v. Cudd Pressure Control, Inc., 271 S.W.3d 228, 233 (Tex. 2008) (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) cmt. e (AM. LAW INST. 1971) ("[s]tanding alone, the place of contracting is a relatively insignificant contact. . . . [and t]he place where the parties negotiate . . . is of less importance when there is no one single place of negotiation and agreement")).

[104] *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 193 cmt. b (AM. LAW INST. 1971).

[105] *See id.* § 193 cmt. a ("There may be no principal location of the insured risk . . . . In such a case, the location of the risk can play little role in the determination of the applicable law"); *see, e.g.*, Fallon v. Superior Chaircraft Corp., 884 F.2d 229, 234 (5th Cir. 1989) (describing the application of the laws of multiple states to a policy covering risks in multiple states as "an anomalous result [that] would wreak havoc in the insurance industry").

[106] *TV-3*, 28 F. Supp. 2d at 421 n.23.

ple, in *Anderson v. Virginia Surety Co.*,[107] the court determined that Maine law applied "because the insured risk, [the] airplane, was located in Maine." ("[I]t may be assumed that [the parties] entered into the insurance contract with the expectation and implied intent that the local law of the state where the risk is to be located would be applied to determine issues that may arise under the contract.").[108]

VIII. INSURANCE AND DEFENSE COUNSEL

Most tort cases with an aviation component to them will involve at least one insurance policy. If a suit triggers the insurer's duty to defend, defense counsel will be assigned to defend the insured. Defense counsel must have a sufficient understanding of the possible insurance issues involved to fulfill their obligations to defend their client.

A. Determine What Insurance Might Be Available

From the outset, counsel should be aware of what potential insurance coverage there is for a particular claim. There might be additional or excess coverage from a policy other than the primary aviation policy. Additional insurance might be in the form of another policy issued with the client as the named insured (e.g., a Commercial General Liability Policy) or as a result of a contractual obligation to defend or indemnify (e.g., a purchase and sale agreement or a flight service agreement). Knowing the full breadth of the client's insurance program is also essential for making appropriate disclosures during the course of the lawsuit. Federal Rule of Civil Procedure 26(a)(1)(A)(iv) requires a party to provide "any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment."[109] Many state court discovery rules contain similar requirements.[110]

---

[107] 985 F. Supp. 182 (D. Me. 1998).

[108] *Id.* at 186 (quoting Baybutt Const. Corp. v. Commercial Union Ins. Co., 455 A.2d 914, 919 (Me. 1983), *overruled by* Peerless Ins. Co. v. Brennon, 564 A.2d 383 (Me. 1989)).

[109] Fed. R. Civ. P. 26(a)(1)(A)(iv).

[110] *See, e.g.*, Tex. R. Civ. P. 194.2(g) (mandating disclosure of any indemnity and insuring agreements).

B. Confirm If the Defense is Subject to a Reservation of Rights

Whether the insured is being defended subject to a reservation of rights can have an effect on privilege issues. It also might trigger the involvement of additional counsel. If an insurer is defending under a reservation of rights, some states recognize that a conflict of interest arises for the attorney appointed by the insurer to defend, resulting in the right of an insured to hire independent counsel at the insurer's expense. Whether defending under a reservation of rights triggers the right to independent counsel varies by state.[111]

Although defense counsel should be aware of and investigate sources of insurance, it is not the role of defense counsel to comment on matters of coverage. If there are coverage issues that arise during the course of defending the suit, the insured, insurer, or both should retain independent coverage counsel for advice.

C. Protect Privileged Communications

There is no general privilege between insurance companies and their insureds.[112] Thus, counsel reporting to insurers should be mindful of taking steps to protect those communications and prevent them from becoming the target of discovery requests.

---

[111] For a state by state survey of whether the insured has a right to independent counsel at the insurer's expense, see David B. Applefeld et. al., *Independent Defense Counsel: When Can The Policyholder Select Its Own Defense Lawyer and How Much Does the Insurer Have to Pay? A 50-State Survey*, Am. Bar Ass'n (2014), http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2014_inscle_materials/written_materials/p3_2_independent_defense_counsel_50_state.authcheckdam.pdf [https://perma.cc/XR4T-PJGC].

[112] Linde Thompson Langworthy Kohn & Van Dyke, P.C. v. Resolution Trust Corp., 5 F.3d 1508, 1514 (D.C. Cir. 1993) ("Federal courts have never recognized an insured-insurer privilege . . . ."); *In re* XL Specialty Ins. Co., 373 S.W.3d 46, 53 (Tex. 2012) (discussing Texas law); *see* Durkin v. Shields, 167 F.R.D. 447, 451 (S.D. Cal. 1995); *c.f.* Richard C. Giller, *Confidentiality and Privilege in the Insurer–Policyholder–Defense Counsel Relationship*, Am. Bar Ass'n, http://www.americanbar.org/litigation/committees/insurance/articles/marapr2012-confidentiality-privilege.html#_edn3 [https://perma.cc/DR2D-HLM9] (observing that three states—Illinois, Indiana, and Missouri—recognize an insurer-insured privilege). Note that a "federal court is not bound to recognize state privileges in federal question cases." Garrett v. City of San Francisco, 818 F.2d 1515, 1519 n.6 (9th Cir. 1987) (holding personnel files discoverable in federal civil rights action despite claims of privilege under state law). Claims of privilege are determined under federal law when an action involves both state and federal law claims. *See* Enns Pontiac, Buick, & GMC Inc. v. Flores, No. CV-F-07-01043 LJO-BAM, 2011 WL 6181924, at *3 (E.D. Cal. Dec. 13, 2011).

Importantly, the fact that there is no explicit protection for insured and insurer communications does not mean that the communications are not privileged. There are other privileges, such as the attorney-client privilege, attorney work-product doctrine, and common interest or joint defense doctrine,[113] and "[t]he absence of a general insurer–insured privilege does not preclude the applicability of other recognized privileges that arise in the course of the insurer–insured relationship."[114]

If an unqualified defense is being provided, there is little danger that communications with the insurer could ever be discovered as the interests of the insured and insurer are aligned.[115] Consider the situation in which a defendant is being defended subject to a reservation of rights, or when another party has agreed to defend the client (e.g., through a contractual indemnity provision) even though the third party's interests are aligned with the insured. Under those circumstances, the communications to the insurer or third party indemnifier should be carefully analyzed before disclosing privileged information to the third party (the insurer or indemnifier). A policy will typically have a cooperation clause, requiring the insured to report to the insurer and cooperate in the defense. A typical cooperation clause might provide:

> c. You and any other involved insured must:
>
> (1) immediately send us copies of any demands notices summonses or legal papers received in connection with the claim or suit;
>
> (2) Authorize us to obtain records and other information;
>
> (3) Cooperate with us in the investigation or settlement of the claim or defense against the suit; and
>
> (4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the

---

[113] *See, e.g.*, N. River Ins. Co. v. Columbia Cas. Co., No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *2–3 (S.D.N.Y. Jan. 5, 1995).

[114] *In re* Tex. Health Res., 472 S.W.3d 895, 901 (Tex. App.—Dallas 2015, no pet.).

[115] *See* Sawyer v. Sw. Airlines, No. Civ.A.01-2385-KHV, 2002 WL 31928442, at *3 (D. Kan. Dec. 23, 2002) (discussing the application of the attorney client and work-product privileges to communications between defense counsel retained by an insurer and the claims attorney, and holding such communications were privileged).

insured because of injury or damage to which this insurance may also apply.[116]

In *Lectrolarm Custom Sys., Inc. v. Pelco Sales, Inc.*, the U.S. District Court for the Eastern District of California, applying federal law, considered discovery requests intended to discover all communications between an insurer (defending under a reservation of rights) and its insured.[117] The court recognized that there was no general privilege applicable to insurer/insured communications.[118] However, when an insurance carrier is defending the underlying lawsuit—even under a reservation of rights—the insured and the insurer share a "common interest."[119] Disclosures of privileged information between the two would not waive an existing privilege.[120] The court concluded that due to their common interest, disclosure of privileged information by the insured to its insurer did not waive the attorney client privilege or the work-product doctrine.[121]

IX. CONCLUSION

The outcome of an insurance coverage issue can often be determined by actions that take place soon after the loss. Whether notice of a claim is made promptly and correctly can be the difference between a loss that is covered by an insurance policy and one that is not. Various procedural mechanisms, such as pursuing early declartory judgments and selecting the proper forum to resolve the dispute, can also be outcome determinative. In the aviation insurance context, it is important to appreciate these issues to obtain the best outcome for the client. While this overview does not begin to address all of the insurance issues that arise in this context, having a general understanding of the insurer's duties and common coverage issues in aviation policies should assist counsel in providing sound advice to clients.

---

116 *See* Lectrolarm Custom Sys., Inc. v. Pelco Sales, Inc., 212 F.R.D. 567, 568 (E.D. Cal. 2002).

117 *Id.* at 569–70.

118 *Id.* at 571.

119 *Id.* at 572.

120 *Id.*

121 *Id.*