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GENERAL CONDITIONS AND ENDORSEMENTS

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In an industry as dynamic and competitive as aviation insurance, anything that smacks of standardization may well lack support because of its impact upon an underwriter's freedom and style. Traditionally, he competes for business on three fronts—price, coverage, and service—so to narrow his coverage options is to limit one area of his competitive field. However, this is not what is being advocated here, but rather a standard way of saying the same thing. That is, there should be one “best way” of setting forth conditions dealing with such common items as arbitration, cancellation, other insurance, and the like. The underwriter can still innovate on special conditions where he can upgrade and embellish coverage terms, such as in supplementary payments.

In standardizing the most common terms and clauses, there is also the added advantage of amassing a more meaningful and trustworthy set of judicial interpretations. The underwriter and attorney will then share common ground and be better prepared to deal with the unusual questions of intent and coverage.

From the review of the dozen or so forms supplied for this project, it appeared that three-fourths of the companies dealt with essentially the same subjects and in almost identical wording. There were some changes, perhaps prompted by the aversion to being labelled unimaginative.

The grouping of conditions by either type of condition or coverage set seems to reflect the current state of the art. The proposed conditions are arranged by coverage section—liability and medical payments, physical damage, and general conditions. Each of the three sections is further organized in the sequence that the mythical insured might be seeking information; that is, in the event of an

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accident he might first inquire about his duties and then the amount of insurance available and later on the adjustment and the filing of notices and proofs.

Now to the reasoning behind some of the more significant conditions in the standard aviation policy.

A. LIABILITY AND MEDICAL PAYMENTS

Condition 1. Insured's Duties

Clause (a): The last sentence of this condition requires that the insured take prompt action to avoid other injury after becoming aware of the initial accident. This wording is tied to general liability changes which were introduced about ten years ago and reinforces the underwriter's contention that a loss must be unexpected from the insured's standpoint. It would follow, then, that after the first accident, such as a slip and fall, other accidents from the same cause could be expected.

Condition 2. Limit of Liability

The value of the first paragraph is that it sets forth the parameters within which the company's total limit is contained. Regardless of the number of insureds, persons injured, claims made, or aircraft involved, the total payments are, nonetheless, subject to the combined limits of liability.

In the last sentence, the company is no longer obligated to pay or defend after the limits of liability have been exhausted. Though some states, notably California, are very adamant on an insurer's obligations to defend, this is an attempt to limit the company's involvement to only those claims and expense dollars provided for in the policy. A company should not be forced to carry reserves for continuing defense costs for subsequent claimants after judgments or settlements have exhausted the limit of liability.

Condition 3. Proof, Reports, and Payment of Claims

For medical payments, some companies prefer a one-year limit, which is reasonable when considering that there is other recourse available under the legal liability coverages. That limitation, however, has not been proposed because of the comparatively low limits for medical payments coverage. Also, from a practical standpoint, medical coverage frequently responds for funeral costs, with time being of no real consequence.

B. PHYSICAL DAMAGE

Condition 5. Insured's Duties

Clause (a): Most companies will respond to legitimate costs incurred to protect an aircraft following loss, perhaps viewed as a supplementary payment. However, seeking to avoid the stigma of "maybes," this condition states that protection costs incurred with a covered loss are payable in addition to the amount of insurance.

Clause (b): Requiring the insured to give notice to the police of theft or robbery is necessary because of the speed with which thieves, especially organized rings, can dispose of stolen property. It may also uncover claims that are not truly the result of theft.

Clause (d): Insurance companies have differing views on the offering of rewards, sometimes fearing unfavorable publicity. However, the International Theft Bureau, supported by a number of insurance underwriters, does make use of rewards. The inclusion of this statement in the condition is intended to give the company the option of using a reward rather than being billed for it after the fact.

Condition 6. Limit of Liability

For several years now, there has been a definite trend to pay total losses on the basis of amount of insurance less deductible, if any, otherwise known as "stated amount coverage." In part, this has been brought on by the pressures of competition and consumerism.

It is interesting to note that the Montana insurance code specifies that for a total loss the insurer cannot pay more than the actual cash value, less any deductible. Nonetheless, the trend is established, and, presuming the underwriter is not concerned with a "moral hazard," seems to present no real problem.

Contrary to the liberalized adjustment of total losses, partial losses are still being adjusted on the basis of actual cost to repair or replace. Almost without exception, underwriters are using the phrase "like, kind, and quality" to handle partial losses, and inherent in this approach is at least the inclination to adjust for depreciation.

Depreciation may not be a major consideration on smaller partial losses; however, it should definitely be considered when

adjusting more expensive components such as a turbine engine. Such an engine, only a few hours away from overhaul and worth up to several hundred thousand dollars a copy at zero time, should not be adjusted without deduction for the number of hours used. Otherwise, the insured is trading a heavily depreciated component for one in new condition with a resultant betterment of large proportions.

Condition 8. Return Premium for Total Loss

The insurance market is divided on the issue of returning physical damage premium for a total hull loss. Again, the pressures of the marketplace have had an impact. Most "broad form" or "special form" policies provide for return of the unearned portion of the premium. An argument advanced is that the premium is based on twelve months of coverage, as opposed to the other theory that the premium covers a specific aircraft. The purist would tend to follow the latter position with the premise that in the event of a total loss the company has responded in full and is therefore entitled to the total premium.

Oregon, however, relates the amount of hull premium to the amount of hull loss and requires that if the payment for a total loss is less than the amount of insurance, the company shall refund the portion of premium representing the unpaid amount of insurance. Nonetheless, because the movement is so well established, the proposed conditions provide for a return premium on all total losses.

Condition 12. Automatic Insurance for Increased Value

This condition falls into the realm of supplementary payments, referred to earlier as the area where the underwriter can expand the concepts of coverage, or, if you will, compete by way of form. The reasoning behind this provision for automatic insurance on increased value is that it is not uncommon to modify or refurbish aircraft or add expensive equipment during the term of the policy; these changes can appreciably increase the value and thereby require a larger amount of insurance.

Condition 13. Supplementary Payments

For much the same reasoning as applied in Condition 12, it is not uncommon to have stolen aircraft recovered without damage

but several hundred or thousand miles removed from the place of theft. Through the years, insureds have had to bear the added expense, usually through no fault of their own, of retrieving the aircraft. Under the assumption that theft losses are for the most part fortuitous, it seems reasonable to provide a modest sum to cover retrieval costs. If the aircraft were damaged, even slightly, repair costs, including retrieval and transportation, would be borne by the underwriter.

C. GENERAL CONDITIONS

Condition 17. Subrogation

The second part of the subrogation clause allows the insured to waive the company's rights of recovery as long as the waiver is given in writing and prior to an impending emergency. This provision is of principal value in trying to avoid damage from natural disasters such as hurricanes, tornadoes, and floods, where owners of protective facilities may require waivers. This is a reasonable extension offered in the interest of reducing loss to both the insured's and company's benefit.

Subrogation for admitted liability and medical payments is hard to obtain in most states, under the theory that these two coverages are akin to accident coverage—a two-party contract. Moreover, Kansas and Oklahoma are specific and require that policies be amended to rule out subrogation for medical payments.

Condition 19. Inspection and Audit

The first paragraph of this clause has developed primarily because of lawsuits brought in the 1960's alleging that in making a survey or inspection the insurer was in effect implying in its report that all exposures or problem areas were identified. This condition is now fairly well established as a means of protecting the company in its efforts to gather underwriting information without incurring the obligations of a guarantor.

Condition 20. Other Insurance

The provision that excess insurance be treated as such is not yet widely used, but it is justified considering that excess carriers, without any detriment to the insured, base their premium on the assumption that underlying coverage will be exhausted before they are called upon. Other than that, it is reasonable to expect primary

underwriters to participate in a loss on the basis of their proportion of limits. With respect to non-owned aircraft, again the coverage is excess because insurance normally follows the aircraft and so should be available to those using it, with certain qualifiers mainly directed at commercial operators.

Finally, to protect companies from unknowingly pyramiding limits under several policies covering the same exposure, perhaps written by different departments, there is provision to apply only one limit, that being the highest under any one policy.

Condition 22. Cancellation

Most financial institutions and a number of state regulators are requiring that insurers provide at least thirty days notice of cancellation, so it seems reasonable to adopt that provision. There has been some argument against the longer period, based on a possible conflict involving the cancellation provisions of reinsurance contracts. The underwriter could not afford to provide coverage on a risk for a term longer than that for which his reinsurance might apply. As a rule, cancellation periods should not exceed similar conditions in reinsurance contracts, and most of them have provisions for at least thirty days advance notice of cancellation.

A minority of companies have adopted the position that non-payment of premium is deemed a request to cancel by the insured. This, in part, relates to the tactic whereby an insured, to avoid a short rate penalty, can refuse to pay the advance premium or an installment with the hope that the company will be forced to effect cancellation on a pro rata basis.

Index

The last part of the conditions' section is an index which should more effectively appear as a separate item at the beginning of the policy or be part of the declaration page or policy jacket. The index came into being at the request of the state of Florida that insurance contracts have an index to facilitate the insured's locating key provisions.

In the move to make contracts more easily understandable, it makes sense that there be some form of guide or index for the insured. Moreover, this portion of the contract should point out, in bold type, the importance of the "pilot" and "purpose of use" clauses.

II. BREACH OF WARRANTY/LOSS PAYABLE ENDORSEMENT

The breach of warranty or loss payable endorsement has long been a source of confusion for lienholders, underwriters, and insureds. The confusion seems to be in determining what coverage afforded under the policy is for the named insured and what coverage is separately provided to the lienholder. Many such endorsements relied on the term "this insurance," which was interpreted as meaning the insurance afforded by the policy for the insured.

The latest legal advice finds that, as a general rule, breach of warranty endorsements extend to the lienholder the identical coverage provided the named insured in insuring agreements and exclusions, whereas conditions apply only to the named insured. This tends to reinforce the key phrase stating that coverage for the "lienholder shall not be invalidated by any act or neglect of the insured." Paragraph I is intended to clarify this, subject to four exceptions dealing with hazards that might be considered commercial or within a banker's retained risk.

This endorsement contains the basic elements of a policy. Part I acts as the insuring agreement followed by four exclusions. In paragraph II are the limits of liability, and in paragraphs III, IV, and V, the general conditions.

III. AIR TAXI FORMS

There is a hesitancy to do much to the standard endorsement (CAB 262), since a number of underwriters were involved in its development some years ago, and most have learned to live with it. In paragraph 4, because many commercial risks are written on a reporting form basis or have provisions for substitute aircraft, it was advisable to strike the last statement dealing only with aircraft described in the policy by FAA number.

In light of the trend for other classes of insureds and toward the more conservative use of exclusions, exclusion M has been deleted in this proposed form as being overly restrictive. This is primarily because it can so broadly void coverage for aircraft that have not had inspections, maintenance, etc., or, if done, not performed by persons authorized by Federal Aviation Regulations. In this case there are too many technicalities upon which to base a declination of coverage.

To reinforce the applicability of the basic insurance contract, the amendatory endorsement was devised with the idea of more closely tying the insurance contract to the CAB's standard endorsement. In the second paragraph, the intent is to preclude paying more than the required limits or policy limits in a case where the underwriter might respond to the government's requirements and then subsequently be asked to respond under the original policy for its higher limits. In other words, the combination of CAB limits and policy limits, for a named insured or others, cannot exceed the policy limits.