

## Does Your Policy Have The Right Stuff?

by Thomas H. Chappell

We receive many phone calls and questions concerning the amount of insurance being placed on aircraft as the insurance renews. Now that we find ourselves in the depths of a hard aviation insurance market, insurance prices are at historic highs. As expected, many aircraft owners and operators are scrambling to reduce premiums. Some of the solutions make good economic sense. Others can be devastating in the event of a loss.

As we have discussed many times, the insurance industry goes through market cycles. The premiums and the underwriting rigidity increase during hard markets. During soft markets the premiums decrease and underwriters become more cooperative. For the past two years, we have experienced a very hard market. In fact, this market may have set new benchmarks, never to return to the extremely low prices of the past. But, that is a topic for another time.

With the increase in premiums, many of our clients and friends seek economic relief and respond with coverage reduction requests or operation decisions that are intended to result in lower premiums. Many of these requests and decisions jeopardize or void coverage.

- Cheating on the pleasure and business policy “purpose of use” by renting your aircraft to a friend or a friend’s business. (This could void your coverage.)
- Reducing limits of liability not because of availability but to save money. (Are the limits you traditionally purchase selected because they were needed or were they bought just because high limits of liability were cheap during the soft market?)
- Leasing an aircraft to a charter operator and moving the insurance to a fleet policy. (Although this is often a good solution to many ownership problems, remember, commercial aviation insurance policies are often not as broad as individual policies.)
- Underinsuring the aircraft hull (aircraft physical damage).

There is no question that the value of used aircraft has decreased during the current economic downturn. In fact, certain makes and models of aircraft have dropped by as much as one third. In cases such as this, it only makes good sense to reduce the amount of hull insurance to the true replacement value of the aircraft. The *Aircraft Blue Book Price Digest* is the quick reference that the underwriter uses to establish a general value for insurance purposes. I am not saying that this guide is always accurate for a specific aircraft, but it gives us a place to start. Of course, our goal is to insure the aircraft for its replacement value. Remember, your insurance policy is written on an agreed, or stated value basis. It is the amount of hull value shown on your policy that will be used to adjust all hull claims.

“But I only owe the bank half the value of the hull and I am willing to take the risk (self insure) for my half.” Unfortunately, the contract (insurance policy) doesn’t work like that. As mentioned above, the policy is written on an agreed amount basis. If your aircraft would cost \$200,000 to replace and you insure it for \$100,000, it could be said that you are 50% insured to value. In the event of a total loss, the insurance company would write you a check for \$100,000 and take the salvage. If this makes you and your banker happy and you have saved valuable premium dollars, you have accomplished your goal.

But what if the loss does not result in a total loss? In most aircraft accidents, the loss is a partial loss. In our example, this means the insurance adjuster will establish a cost to repair. He will also obtain salvage bids. If we carry \$100,000 hull insurance on a \$200,000 aircraft and have a \$70,000 partial loss, and the adjuster obtains a \$130,000 salvage bid, what do you think you will receive in the form of a settlement? If you were the adjuster, would you repair the aircraft? Or, would you declare the loss a constructive total loss, take title to the salvage and pay the insured the face amount of the policy, \$100,000.

How much did you save in premium? If you were quoted a 2% hull rate for the \$200,000 aircraft, you would have been charged a premium of \$4,000. If you decreased your hull value to \$100,000, would you expect to pay \$2,000?

Unfortunately, things are not always so simple. The underwriters charge more per \$100 of hull protection for a lower valued hull than they do for a higher value aircraft. As the value decreases, the hull rate per \$100 increases.

In our above example, the \$100,000 hull might be charged with a 3% or higher rate. This would result in a lower savings and may not be worth the risk.

This is referred to as rate banding. It is easily seen in the life insurance industry. An individual who purchases \$1,000,000 in death benefit will pay less per \$1,000 of coverage than if he purchased a \$100,000 policy.

Although I cannot understand the reason for rate banding in the life insurance industry, in aviation insurance it does make some sense. The aviation underwriter is simply looking for some minimum amount of premium in the policy to handle the most frequent, small, partial loss.

In short, be careful when drastically reducing your hull values. Moderation may be the best solution. A slight reduction in insured hull value may not result in increased rates or in problem claims. The best advice, however, is to fully insure your aircraft. Insure it for the estimated replacement value.

## **Beware Of The Fellow Employee Exclusion**

Have you ever heard of the Fellow Employee Exclusion? Well it is prevalent in many commercial auto policies and other commercial liability policies. Yes, you guessed it; many aviation insurance policies contain it too. Look at your policy. It may say, "... Nor will we cover any liability claim against any employee, including your own employees, who, while working within the scope of his or her duties, injures someone who works for the same employer".

The Fellow Employee exclusion is designed to eliminate coverage in an employee versus employee lawsuit. This would occur as the result of one employee's negligence in a work related injury case.

The employer carries worker's compensation, which is considered to be sole remedy if a worker is injured on the job. Sole remedy means, the injured employee is entitled only to the benefits designated by the state of domicile or the state in which the injury occurred. In most cases, the injured employee is entitled only to those benefits and cannot pursue legal action against the employer in search of a higher settlement.

What about the worker (employee) who caused the accident due to his negligence? He has no protection under his personal liability policies (homeowners, personal auto, personal umbrella) due to specific exclusions dealing with work related losses. So, he must be covered under his employer's policies, right? Wrong. The employer's business auto policy, or in the event of an aircraft, the employer's aircraft liability policy, may exclude coverage for the negligent worker/employee.

This could be the owner of the company who flies or drives on company business and carries employees as passengers. In many cases, the owner of the company is a stockholder of the corporation, but in reality is also an employee of the company and is subject to the fellow employee exclusion as any other employee.

### *How can an employee be covered for such a liability?*

Find out if your policy contains such exclusions. If it does not, there is coverage for the employee to the limits of the policy. If it is excluded, ask your agent if your particular underwriter will remove the exclusion by endorsement. This may be good advice for other liability policies as well. Business auto policies often contain this exclusion.

In the general property and casualty industry, the "Fellow Employee Coverage" endorsement may be written with respect to all employees or for specific employees or positions. This form usually states, "The Fellow Employee Exclusion contained in Section II – Liability Coverage does not apply to the "employee(s)", job title(s) or position(s) named or listed in the schedule". A broader wording may say, "The Fellow Employee Exclusion contained in Section II – Liability Coverage does not apply." As in the aviation insurance industry, some underwriters make fellow employee coverage available for a fee, some at no charge and others will not or cannot offer it at all.

I have often heard the advice, “just add the employee as an additional insured”. The inference is that naming an employee as an additional insured is supposed to be the universal solution. Just naming your employee pilot as an additional insured will not solve the fellow employee dilemma. The additional insured is protected in many situations but is subject to all the exclusions, terms, and conditions contained in the policy. If the fellow employee exclusion is in the policy, it applies to all employees whether added as an additional insured under the policy or not.

Remember, most liability policies (except worker’s compensation policies) exclude work related injury, death or disease. An example of this policy wording might say, “What is not covered: We do not cover any bodily injury to any person in the course and scope of employment by you or by someone we protect for any claim against you, against someone we protect, or against a fellow employee.” In other words it is expected that the employer purchases worker’s compensation insurance. This exclusion also applies to the additional insured.

**What Is The Position Of Each Specific Insurance Company? Which will and which will not offer the fellow employee coverage?**

<b>Underwriter Policy Form</b>	<b>Is The Fellow Employee Exclusion Included?</b>	<b>Can The Exclusion Be Removed?</b>	<b>Underwriter Comments</b>
<b>Aerospace Insurance Managers</b>	Yes	No	Do not offer this coverage.
<b>AIG Light Aircraft</b>	Yes	No	Do not offer this coverage.
<b>AIG CAV</b>	Yes	Yes	Can be removed by endorsement
<b>AIG Gold Medallion</b>	No	N/A	The Gold Medallion policy form does not exclude fellow employee.
<b>Global Aerospace Broad Horizon</b>	No	N/A	The Broad Horizon policy form does not exclude fellow employee.
<b>Global Aerospace Golden Wings and FHL</b>	Yes	Yes	The exclusion can be removed at little or no cost.
<b>Global Aerospace PBO</b>	Yes	No	Underwriters told us, the exclusion would not be removed for any reason.
<b>London Aviation Underwriters</b>	No	N/A	The policy does not contain the fellow employee exclusion.
<b>Phoenix Aviation Underwriters</b>	Yes	Possible	They rarely remove the exclusion and when they do an endorsement charge of \$500 is charged for a maximum limit of \$250,000.
<b>U.S. Specialty</b>	Yes	No	Underwriters told us, the exclusion

<b>Insurance Company</b>			would not be removed for any reason.
<b>USAIG 360</b>	Yes	Yes	Removed by endorsement on a case-by-case basis.
<b>USAIG 400</b>	Yes	Yes	Removed by endorsement on a case-by-case basis.
<b>W. Brown</b>	Yes	Yes	Can be removed by endorsement on a case-by-case basis for a fee.

Agents, as a rule, do not automatically request that the fellow employee exclusion be removed. Some do not know it exists, others do not know the client's needs. Do not assume that this detail meets your needs or wishes. Call your agent and ask if this coverage is needed. Remember, your particular insurance company may not offer fellow employee coverage. →