LIABILITY LIMITS

We Can’t Discuss Liability Limits Enough

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The best and most frequently asked question posed to me as an insurance advisor is “How much liability insurance should I carry?” In past articles, I have given the answer that if you can tell me how much you are going to be sued for, I can tell you how much will be enough. Obviously, no one can predict the future. The next best thing would be to purchase as much liability as you can afford or as much as you can get. At least with this answer, you have done the best you can do.

During soft markets such as the one we are currently experiencing, premiums are cheap and underwriting capacity is plentiful. Less-experienced pilots may qualify for more liability than they would during tight underwriting markets. But with the MU-2, it is far more than a soft underwriting market that is affecting the cost of insurance and availability of limits.

There is the reputation of the Mitsubishi. Since the advent of the SFAR training, the safety record of the MU-2 has been greatly improved. Not only has it improved, it seems to be a sustainable record. With standardized training, the MU-2 went from having the worst loss record in the turboprop fleet to best. This safety record alone, in a few short years, has reversed the poor reputation of the aircraft and turned it into “a diamond in the rough.” The results have benefited everyone in the MU-2 world. The owner is being rewarded with increasing aircraft values and with the favorable recognition of the underwriters; we are paying less today to insure the MU-2 than ever before. Decreased premiums and increased availability of limits and the MU-2 owner is the big winner.

Although the aviation underwriting community hates to hear me say it, aviation insurance underwriting is more of a gamble than traditional underwriting in market sectors such as Life Insurance, Property Insurance, or Workers’ Compensation. In other sectors of insurance, underwriters have the advantage of actuarial tables, which if followed, remove the gamble from the underwriting decision. The Life Insurance underwriter, for example, knows exactly how many 30-year-old, white, male, non-smokers will die this year. It is easy then to calculate how much premium each must pay in order for the company to have adequate policyholder’s surplus to pay the known losses and make a reasonable profit.

Why do aviation underwriters not follow their actuarial statistics when pricing their products or when deciding whether or not to accept a risk? Actuarial tables are predicated upon the law of large numbers. The law says that the larger the group, the more accurate the actuarial tables and the less the underwriter’s gamble. In aviation, we do not have enough aircraft to develop accurate statistics. With only an estimated 357,000 aircraft and 617,000 pilots in the United States (2010 statistics), we have too few numbers for the law to apply. In addition, we have no homogeneous underwriter grouping. We have a U.S. fleet ranging from Lear Jets to B-747s and from G-550s to Piper Warriors. Our stable of pilots' qualifications is equally as diverse with skills varying from the highly trained ATPs down to student pilots.

And, with our aircraft usage ranging from pleasure aircraft to commercial airliners, we simply do not have the benefit of the law of large numbers, no homogeneous underwriting grouping and no real actuarial advantage.

As a result, the aviation underwriter follows the competitive market. During times of high capacity, the "rule of the day" is to cut prices and buy or retain as much market share as you can. Cheap brings business in the door. It also causes poor loss ratios. High liability limits for bargain prices also get the attention of many insurance buyers. During soft markets, aviation underwriters will accept high liability exposures in the primary liability layer that can only be dreamed of during times of hard markets.

So if high limits are available for bargain prices, buy all you can get. It is when the capacity dries up (it eventually will) and the price goes up that you must become a more astute buyer.

So how much liability insurance should I buy? Often a client will say that they need $2 million liability limits because they have a net worth of $2 million. Ask any attorney, and I believe they will agree with my next statement: "There is no correlation between your net worth and the amount someone is likely to sue you for." In our example, if you buy a $2 million liability policy, there is absolutely no guarantee that the courts would stop at your policy limit. What you hope for is a good defense and an adequate limit to pay the negotiated claim without having to tap your personal assets.

If net worth is no guide, what is? Maybe we should ask a few questions. Are you a high profile individual? Many aircraft owners are. Do you own a business? Is your name often in the society section of the newspapers? Is your wealth common knowledge throughout your community? If the answer to these questions is "yes," you may be a lawsuit target. This should be encouragement to buy higher limits of liability.

What is your Average Passenger Load? Do you fly primarily on business and alone? If so, you may need less passenger liability. Although the insurance buzz word "smooth limit" of liability has become the fad, it may not be exactly what you need. A smooth limit of liability means there are no passenger seat limitations. A $2 million smooth limit of liability is more properly referred to as $2 million combined single limit (CSL) including passengers. But if you always fly alone, would you not be equally protected by buying $2 million CSL restricted to $100,000 per passenger seat? Who cares how much passenger liability you have if you don't carry passengers? The premium savings can be enormous. Underwriters think of aircraft liability exposures in two separate parts: Third-party Bodily Injury and Property Damage Liability (BI & PD) and Passenger Liability. Since the majority of aviation liability claims dollars are paid as a result of passenger claims, this is the sector that is most expensive when pricing the insurance product.

Here is an idea. Use some of the savings and raise the limit of liability to $5 million CSL restricted to $100,000 per passenger seat. It is not that much more premium.

OK, so you carry passengers on an occasional basis or regularly. It doesn't matter; the exposure is there. It only takes one time to have a loss. This begs another question: Who is your typical passenger?

Do you often invite high-profile guests? If so, your passenger exposure is greater than if you carried your gardener. This would call for higher limits of passenger liability.

What is the capacity of your aircraft? What is your average passenger load? Your exposure is greater in an MU-2 than in a Cessna 152 because of the potential passenger density. The difference is reflected in the underwriter's premiums.

If your aircraft is in the name of your business and your passenger is an employee of the company, your aircraft liability insurance policy will not answer if the employee is injured in the course of his work. Why? Workers' Compensation insurance is "sole remedy" in most jurisdictions. Statutory benefits apply and casualty policies, including aviation liability, are designed not to overlap Work Comp coverages.

Remember, I said if the aircraft is operated in the name of your business. All too often, the aircraft is owned in an LLC that in turn is owned by the primary stockholder of the corporation. In many cases, the corporate owner performs duties as corporate pilot in the LLC's aircraft believing his company's Work Comp coverage is the answer to all his resulting exposure. Wrong.

The employees are not employees of the LLC. They become guests of the owner on his LLC's aircraft. This opens the door to a lawsuit not just against the LLC but against the owner personally. If they are flying with the owner on the owner's (LLC's) aircraft on business, the corporate Workers' Compensation policy will come into play but only as sole remedy for the true employer. High passenger limits or liability just became very important. I have just described an expensive mess.

It is very important to get all these items and ownership correct. And yes, buy higher limits of passenger liability. In today's underwriting world with the current soft market and the improved reputation of the MU-2, you can expect to purchase a $5 million limit of liability including passengers. Is $5 million not enough? If you are an experienced pilot, $10 million including passengers is possible and affordable.

Of course, your "purpose of use" may have a huge influence on the need for liability. If your aircraft is used for charter, your passenger exposure is much greater than private use. Usually, the passenger density is greater. Charter services are not cheap. Therefore, you would expect high-profile passengers. Charter companies usually operate in a wider range of conditions and go to busier airports than those frequented by owner-operators.

So the exposure is greater. And the accountability of a commercial operator is held to a higher standard.

Then there is the charter or managed aircraft contract. It seems it always comes down to a contract. Often the party asking for the contract is trying to pass off his responsibility to someone else, anyone else, and that could be you. In these contracts, you will see a variety of hold harmless and indemnification agreements as well as insurance requirements that you may not be prepared to assume. Some may actually have nothing to do with your exposure and may require that you purchase coverage that you may not need just to meet the contract requirements.
Solution? Have your insurance advisor and attorney review the contract before you sign it. There is very little they can do to repair a situation once the paper is inked. I guess this is where the old saying that “you can’t un-ring a bell” comes in. If caught in time, however, you might have an opportunity to negotiate to remove those insurance requirements that do not apply and soften the indemnification wording that makes you responsible for acts in which you should share no responsibility. Hey, negotiation is cheaper than buying insurance.