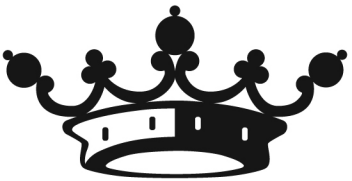
INSIDE THE MINDS

Negotiating Insurance Policy Disputes

Leading Lawyers on Interpreting Insurance Contracts, Obtaining Key Documents, and Resolving Coverage Dispute



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The Unique Role of Aviation Insurance Coverage Counsel

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Introduction

I practice in the area of aviation insurance and reinsurance. Although we look at the same general kinds of issues that arise in the general fields of insurance and reinsurance, we focus on what is peculiar or particular to the aviation industry. Accordingly, we work with policies that are issued to airlines, aircraft manufacturers, or other entities in the aviation industry, including airports, providers of aircraft repairs and other aviation services and aircraft parts manufacturers.

The firm's overall specialty is aviation and many of the people in my firm are involved in aviation litigation. I am focused primarily on the insurance and reinsurance side, so our instructions typically come either from the aviation insurance market in London or domestic insurers who write aviation insurance. Most of my practice involves commercial aviation risks (as opposed to general aviation), which means most of the matters on which we're instructed involve very large risks with high-limit first-party policies covering hull losses (for example, large aircraft or property damage) or high-stakes third-party liability coverages.

Frequent Dispute Areas in First- and Third-Party Liability Policies

Generally, we would be looking at two kinds of policies: first-party coverage where the insured is submitting a claim for damage to its own property, and third-party liability coverage where the insured either had a claim made against it or there is actual litigation. In the third-party liability arena, the kinds of disputes that tend to come up involve the question of whether the damages claimed by the third party resulted from an "occurrence" and whether or not there is coverage for the particular type of event that gave rise to the underlying claim. These are accident-based policies, so the question that must be asked is whether an event occurred that was accidental in nature and caused damage that is covered under the policy. Various exclusions and endorsements can also be the subject of dispute, as is the case in commercial general liability (CGL) matters.

Given the size of the risks and sophistication of the insureds, we tend to deal with manuscripted (customized) policies, which is to say that the individual policy provisions have been negotiated with the particular

insured. Although there are a lot of standard terms that are used in manuscripted policies, the selection of those standard terms are the subject of negotiation. Very sophisticated insureds usually have risk managers and professional insurance people who work for them in-house. These people work with specialized aviation insurance brokers who place their coverage and who act on their behalf and liaise with the insurers in regard to any claims. Consequently, these sophisticated insureds have a lot of input in crafting the kinds of coverage that they want. As a consequence, although the various provisions may be somewhat standard, the policies are customized for the business of the insured. And, because of the unique nature of the aviation industry, these policies may be somewhat different than what you might see in other areas of insurance in terms of some of the concepts that might come into play.

Even though these are manuscripted policies, a surprising number of terms are not defined in the policies, unlike CGL policies. This can lead to disputes. The insurers, brokers, insureds, and the people who service them are a small community (some would say they constitute more of a club), and so it's long been believed that the members are going to act in a gentlemanly way with each other. Over the years, however, as the dollars have gotten higher, disputes and litigation have increased. But some of that "gentlemen's agreement" thinking is still there, which has resulted in policies that are not as heavily amended and revised as those providing CGL coverage, which insurers are constantly reviewing and revising. Purchasers of CGL coverage are more used to off-the-shelf products and purchase policies containing the standard form language currently in use. However, in aviation, we have all of these people who know one another, work with one another, go back to the same markets, and so they feel more comfortable with not defining terms. All of the participants speak the same specialized language, so it is assumed that they have a common understanding of the terms incorporated into policy wordings and if terms are not defined, there is a reason for it. While this works very well in the vast majority of instances, sometimes it can also lead to disputes.

What constitutes an "occurrence" within the meaning of a policy probably tops the list of disputes in third-party coverage, and its close cousin, "fortuitous loss," pops up frequently in first-party hull coverage disputes. In both instances, the disputes tend to arise over an insured's attempt to make

the facts fit within the coverage provided by its policy. As finances squeeze harder, people tend to get more and more creative. One recent example of the latter is a hull coverage case I tried in federal court over the summer involving Fleet Bank and Highland Capital. Extensive motion practice in that case resulted in several decisions on predicate issues of law, including a reported decision (646 F. Supp. 2d 473 (S.D.N.Y. 2009)), in which the court ruled that intentional acts on the part of an insured is not fortuitous and thus cannot serve as the basis for a covered loss. This is a proposition that one would hope would be obvious, but a surprising amount of litigation revolves around this issue.

Trends toward More Precisely Defining Coverages

I think there are now trends toward defining some of those terms. In recent years, particularly on the domestic side, there has been a move toward putting more choice-of-law and forum selection provisions into aviation policies. The absence of choice-of-law provisions has created an area of uncertainty that requires analysis with coverage lawyers to figure out what law might apply for purposes of determining coverage. This move toward specifying governing law and selecting a forum for resolving potential disputes has provided more certainty around the coverages.

Impact of Economic Downturn on Insurance Litigation

I think the economic downturn definitely affects disputes in a number of ways. As I indicated earlier, financial distress tends to make people more creative. Essentially, we see insureds attempting to cast economic losses or breaches of contract as covered losses. Because of the state of the economy over the last couple of years, we have been seeing more of these creative types of claims, not only by operators but also by their lenders and lessors, who are named as additional insureds under the operator's policy. We have also seen an upturn in contingent cover claims. Contingent coverage is purchased by aircraft lessors in a policy that is separate from the operator's policy. The lessor, which owns a fleet of aircraft leased to various operators, will take out its own contingent coverage and pay a premium so that in the event that the operators' coverage doesn't come into play or isn't able to respond to a claim that might arise in connection with one or more leased aircraft, the contingent coverage under certain circumstances will provide coverage to the owner-lessor.

The *Fleet Bank* case actually arose out of a bankruptcy in 2000 filed by Tower Air. Although that was ten years ago, this is another example of what can happen when you have a lot of bankruptcies and troubled operators. A host of claims about their failure to maintain their equipment can arise. When the travel business takes a dip (which it does more often than the overall economy), we get a preview of what is coming with the overall economy, and that is what happened with Fleet. We have finance companies that are trying to recover those losses from insurance essentially because they could not recover from their borrower due to the bankruptcy. This trend occurs in all areas of insurance. During bad economic times, I think there is perhaps more willingness to pursue a claim because everyone is concerned about every penny and how that is going to affect their operations. So, accordingly, you have an increase in claims and disputes.

Because aviation is a specialized field that doesn't generate that much litigation, we are always researching comparable or parallel sorts of policies to use in our briefs, and we are noticing that insureds are trying to get more and more creative about what is an occurrence for purposes of third-party liability coverage, even though an examination of the claims that are asserted against them clearly shows that it's a contract dispute or business tort. They are trying to fit a square peg in a round hole and make everything into an occurrence or negligence claim even when it isn't. The tighter the financial times, the more creative the insured's arguments become.

Insureds sometimes get their brokers involved in coverage litigation so they can argue, "Gee, I thought I had coverage for every conceivable thing and if I don't it must be your fault." In other words, they tend to pull in some "company." We also see situations like the *Fleet* case where the driving force is the additional insured, not the named insured. We had that recently with contractors who named the owner or the operator of the airline as an additional insured. Sometimes there is a question of who is an additional insured; the answer depends on the terms of the contract and the scope of the coverage that is provided under an additional insured endorsement. Coverage tends to be provided to an additional entity that is named under the policy because oftentimes the intention of that coverage is for a limited purpose. However, unless the policy documentation and other things are prepared in the correct way, sometimes the coverage can end up being broader than what was actually intended.

Processes for Handling Disputes

A claim of some kind is first filed. It could be either a first-party claim by the insured or a third-party claim where the insured has been sued or had a claim proffered to them that they then turned over to underwriters (through their broker). In the case of first-party hull coverage, the insured would be asking for payment; in the case of a third-party claim or litigation, the insured would tender its defense to underwriters. I mentioned at the outset that specialized aviation brokers both place the coverage and work with underwriters' claims departments. In the aviation world the insured doesn't usually deal directly with underwriters; these insureds do everything through their brokers. Once the request for payment or tender of defense is made, if there is a question of coverage, we would be instructed to review the claim. We would obtain policy documentation from underwriters, which would include the underwriting slip on which the coverage was placed and the policy wording which we would refer to as the insurance policy itself. We would also gather all of the factual information that might be available at that juncture and begin our analysis of whatever the legal issues might be. The idea is to provide underwriters with an opinion as soon as possible of whether or not there is coverage. Now, as I mentioned, we only get involved if there is a question of coverage. In the field of aviation insurance, the vast majority of claims are handled without involving coverage counsel. The people who handle aviation claims in the London aviation market and here in the United States have extensive experience and depth of knowledge of aviation insurance and the aviation industry. They see many claims on a regular basis, most of which look familiar and are fine.

If the claim presented is a liability situation and a defense lawyer is needed to represent the insured's interest, one is appointed. If it is a first-party situation and more information is needed from the insured about the claim for which payment is being sought, an adjustor will typically go out to look at the aircraft and determine what kind of damage it has sustained. That is handled on a routine basis. It is only when something crosses someone's desk that looks more like a contract dispute than a claim for an accident or some aspect of the claim looks as if it is not covered that our clients will decide to get an opinion from coverage counsel. That is when we would become involved and start the process of gathering the necessary information, analyzing it, and providing an opinion. If it is a liability claim,

that process may involve contacting defense counsel, in which case we always deal with them at arm's length because they are representing the interest of the insured protecting the insured's interests, whereas we are acting on behalf of underwriters.

All steps are taken with the intention of ensuring that the insured's interests are protected at all times. This is done as quickly and efficiently as possible. If a determination is made that there is no coverage, a disclaimer letter would be sent. If, instead, a determination is made that there are issues around coverage of a liability situation, then a defense is owed and a reservation of rights letter would be sent. In some instances where coverage is in doubt, there may be a potential conflict of interest and sometimes that will mean independent counsel would come on board. Some states define conflicts of interest requiring independent counsel more stringently than others. This is one reason why, in our coverage analysis, the choice of law is a major issue. At any rate, in such a situation, the insured might demand independent counsel to represent its interests. Defense counsel appointed by underwriters would be another player in that scenario. They would not, however, become involved in any dispute over coverage.

If the insured takes exception to a reservation of rights or disclaimer, we get into the insurance dispute phase. This may result in separate coverage litigation or underwriters and the insured may decide to enter into some sort of tolling arrangement pending resolution of the underlying litigation and then address the insurance coverage dispute at a later time. In other words, the dispute part can proceed along many different tracks.

Frequent Legal Issues

As I mentioned, choice of law very often is a key issue that we have to analyze. More often than not, the applicable law isn't obvious because the coverage provided by aviation policies is worldwide. Very often the insureds operate in airports around the world and the aircraft are flown anywhere in the world, and the loss or underlying third-party claim or litigation can arise almost anywhere, so that choice of law is usually issue number one to sort out.

We do look at various elements of the policy wording that appear to apply to the particular issue that has been raised by the facts of the claim and

from there we address questions relating to things like occurrence—i.e., do these facts fit within the definition of occurrence under applicable law. Very often we will be looking at endorsements and specific exclusions to see whether those terms come into play with that particular claim. So, for example, issues relating to the contractual liability exclusion can come up, and the question will be: is this a claim that relates to duties that the insured assumed under a contract that are different from those that would be imposed by tort law? Other issues that arise with some degree of frequency involve exclusions for damage that occurs while an aircraft is in the care, custody, or control of an insured manufacturer, and whether economic losses sustained by an insured are the result of physical damage to an aircraft or aircraft product, as opposed to other property.

We also find ourselves looking at the intentional acts exclusion, and how that is interpreted in the applicable jurisdiction. Sometimes some jurisdictions say an intentional acts exclusion only applies if the insured intended to effectuate harm. Other jurisdictions interpret the word "intentional" literally and hold that the exclusion covers a broader range of incidents.

One hot issue for aviation is in the area of potential coverage of punitive damages because in most aviation policies there is no specific exclusion. So you have to look to applicable state law to see whether it is against that state's public policy to cover punitive damages. Then you have to consider whether the claimed or awarded punitive damages are based on vicarious conduct or conduct directly attributable to the insured, and what is the standard for awarding punitive damages where the underlying dispute is pending because that will play into whether the intentional acts exclusion applies. The public policy of the state that interprets the public policy can be different from the state that awards the punitive damage verdict, so you have to look at the interplay of all of those issues in order to determine whether there is potential coverage of punitive damages.

One of the provisions that we have seen crop up recently that appears to be directly related to the downturn in the economy is the Airline Finance/Lease Contract Endorsement known as AVN 67C. Airlines typically are required in aircraft financing agreements and aircraft leases to

make the lender or lessor a loss payee under their policies. This endorsement states what additional rights the financier or lessor has under the policy. We've seen disputes over the intention of this endorsement, which accounts for its revision from time to time (revisions A, B, and now C). The disputes around the subject of AVN 67C arise when aircraft financiers and lessors attempt to cast the losses they incur through the acts of the insured airline as covered losses. That was the central issue in the *Fleet* case and it's an issue we are dealing with again in a matter pending in California. Essentially, if a lessor or lender has difficulty repossessing the aircraft under lease or pledged as collateral, or if the airline removes parts from the leased or pledged aircraft to keep other aircraft flying (a practice known as "cannibalization" that we often see in distressed airlines), the lessors or lenders argue that there has been a conversion that is covered under the hull policy. This is a classic example of trying to make insurance into something it's not. Our response is that these endorsements are not repossession insurance, which itself is a bit of a misnomer because actual repossession insurance policies (which are available, but are expensive) are limited to coverage of situations in which a foreign government prevents the repossession process from being carried out. These arguments we see lessors and lenders making in cases such as *Fleet* are really attempts to have underwriters provide compensation for the airline's breach of contract.

The Specialized Nature of the Aviation Industry

When we are discussing coverage issues underwriters often say their mindset is to pay claims, to act on behalf of and protect the interests of our insureds. There is a very strong feeling in the whole aviation insurance market that underwriters are not looking to nitpick over claims, which generally involve millions and sometimes billions of dollars. It is a small market, a very highly specialized marketplace, and so when we get involved it is because something has raised a red flag in someone's mind.

So, when we are brought in, the market is interested in providing us with background information about the policy and the insured because they recognize that the situation is out of the ordinary. This process does not occur on every claim or every other claim or even every one in one hundred claims. This industry really does deal with the normal claims in the normal

way either by paying the insured in first-party situations or carrying out a typical defense in a liability setting and avoiding whenever possible getting into an adversary posture with an insured. I think that is an important overall note to make. When you look at the reported cases, the ones that actually go to litigation, you get a distorted view because you have insurers saying that there is no coverage and you start to wonder. Insurance companies in general have a reputation for taking your money and then not paying your claims because they maintain you didn't have the coverage you thought you had. But, really, the cases we deal with are not reflective of the overall big picture.

Consequently, owing both to the specialized nature of aviation and the fact that claims in this industry are generally not denied, there is not a large body of law dealing with aviation insurance. Sometimes we need to look at general insurance case law, but these decisions can be difficult to apply. While they may have been heavily litigated (like in the automobile arena), they concern insurance areas that lack the same kind of manuscripted policies and sophisticated insureds and insurance market that aviation has, and they tend to be heavily regulated by individual states. Aviation insurance traces its roots to marine insurance, and that area can sometimes be useful in our research. The CGL cases tend to be at least somewhat analogous and can provide us some guidance. Still, when looking at that whole panoply of the different kinds of cases that are coming out, we have to be careful when applying some of the doctrines and principles to our particular situation because of the differences. Construction cases and products liability cases, for example, may present certain issues that are similar to those we are dealing with and arise out of facts that are analogous to what we are working with, but the policy language very often is different, and so those cases are not squarely on point for us. This means that the legal analysis has to be done very carefully; we cannot use off-the-shelf very general treatises. Instead, our issues have to be pulled apart and very carefully analyzed.

Many knee-jerk statements get thrown around in case law and treatises (sometimes by an insured's attorney) that the insurer is going to lose because the policy is always going to be construed against the insurer and the insured's expectations are controlling. However, those superficial statements don't necessarily apply, particularly where you have a sophisticated insured with all of

these people working on their side of the equation. In aviation, a broker, who is the agent of the insured, drafts the policy wording.

Differences in Handling Claims in the Aviation Industry

I think the people that are involved in aviation claims are extremely experienced and knowledgeable and they play a very hands-on role throughout the process. We rely on them as we go through our analyses and engage in lots of back-and-forth discussion about both the facts and the coverage that was intended to be provided under the policy. I think that the sophisticated nature of the participants in the aviation insurance market and the specialized nature and depth of their knowledge is something different from what you encounter in other industries. When you think about it, an aviation policy very often looks like three or four different kinds of policies put together. You have a fleet of aircraft, most of which can carry a couple hundred passengers that are covered for everything from a major air disaster to damage caused by a mishap with a catering truck or other ground vehicle at an airport. And even the minor occurrences can involve costly repairs because the aircraft must be certified as airworthy before it can be put back into operation. So, in aviation, you are working with people who deal with a very broad range of risks on a daily basis.

When there are disputes over coverage, typically they are handled by litigation as opposed to ADR. While I suppose some policies have arbitration provisions, I haven't seen very many. The reinsurance area is where we see arbitration provisions on a routine basis, but generally not in the insurance coverage area. Depending on the relationship between the parties, oftentimes there is an interest in some sort of early mediation. Generally, as there are many people involved, there are lots of discussions and opportunities to reach agreement prior to full-blown litigation in certain instances. If it is a legal issue, it is a matter of whether there was coverage or not. You win or I win, as opposed to negotiating to settle for a specific amount. Those kinds of disputes tend not to be amenable to mediated resolution early on. However, having said that, I have actually acted as a mediator in some insurance disputes because the parties had an ongoing relationship and a real interest in sitting down and trying to work out their issues. But, again, the nature of the disputes and dollars involved were significant factors in causing the parties to be amenable to that kind of resolution.

To guide us in the process of coverage litigation, we use some specialized materials that have been developed in the aviation area, such as the Lloyd's of London Repository, to help us with issues related to custom and industry usage of particular terminology, as well as the scope and type of coverage that plays a significant role in aviation coverage analysis. In addition, some aviation insurance industry literature might be available but primarily we dig into case law for precedent that is analogous to the issues at hand, and we examine the major treatises like COUCH. In other words, we look at everything that is available to us. How deeply we get into that at the early stages depends on the issues that have arisen. In some instances, we may go back to the actual underwriting department and talk to them about what was going on and the discussions that might have been had with the placing brokers at the time that the policy was being written. We will look at their files, as well as the separate files that are maintained by the brokers. Those are all potential sources of information as we go through our analysis. In spite of these supports, however, lack of analogous guidance sometimes is a big challenge.

Advice for Attorneys

Because these things are very fact-specific, gather as much information as is available. If you ask the question once and get a certain amount of information, you will probably need to ask the question again so that you get even more, and then again so you can really ensure that you have gotten all of the relevant available information. You need to review this information carefully and ask as many questions as you can. Do a thorough factual analysis up front to minimize surprises later on. The other part to keep in mind is that both sides of the dispute often are engaged in an ongoing and important business relationship. Although the insurers are not interested in—nor should they be—paying claims that aren't covered, they are mindful of business considerations and you as counsel need to be mindful of those business considerations as well. Then there is always just the cost factor: you do want to be as thorough as possible and move as expeditiously as possible, while being mindful that full-blown disputes can be very expensive and carry a number of other repercussions, such as those concerning these business relationships. So the practicality of pursuing the dispute needs to be considered as well.

Key Takeaways

- During bad economic times, there is perhaps more interest and willingness to pursue a claim because everyone is concerned about every penny and how that is going to affect their operations. So, accordingly, you have an increase in claims and the creativity of claims, and with it, an increase in coverage disputes.
- Owing both to the specialized nature of aviation and the fact that claims in this industry are generally not denied, there is not a large body of law dealing with aviation claims in particular.
- One hot issue for aviation is in the area of potential coverage of punitive damages because in most aviation policies there is no specific exclusion. So you have to look to the state to see whether it is against their public policy to cover punitive damages.
- Because these things are very fact-specific, gather as much information as is available. If you ask the question once and get a certain amount of information, you will probably need to ask the question again so that you get even more, and then again so you can really ensure that you have gotten all of the relevant available information.
- Although the insurers are not interested in—nor should they be—paying claims that aren't covered, they are mindful of business considerations and you as counsel need to be mindful of those business considerations as well.

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Ms. Posner is a trained mediator and has acted as a private mediator in commercial matters. She also is in the process of being certified as a reinsurance arbitrator through the

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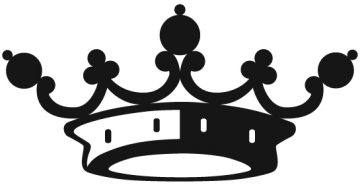

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