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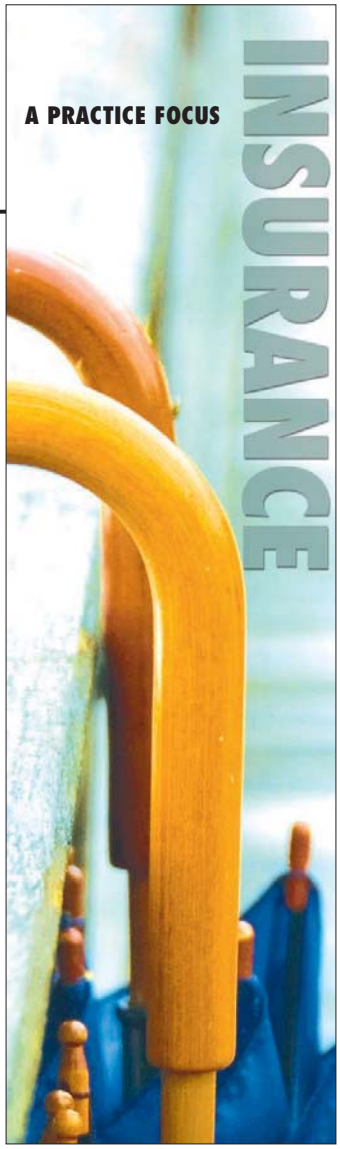
It's Not Just a Technicality

Courts ought to respect the insurance contract that the parties bargained for.



BY JONATHAN H. PITTMAN AND PAUL ALP

Imagine that your car insurance policy states that it provides coverage only for an accident that takes place while you are wearing red socks. If you are wearing blue socks when you rear-end someone, should your insurance company pay, in spite of the policy? Many advocates for policyholders would argue, "Yes, it should" because your breach of the sock-color condition in your contract amounted to a mere technicality, and voiding coverage would be unfair and contrary to public policy.

As a thought experiment, this argument has superficial appeal. In the real world, however, insurance policies routinely contain explicit provisions that establish the scope of the risk insured. Such clauses are not to be taken lightly because, unlike the example of the substantively meaningless sock color, they establish the fundamental nature of the risk that the insurer agrees to cover—the basis of the bargain for which the policyholder pays its premium.

Aircraft liability policies, for example, routinely state that they provide coverage only if the pilot at the controls meets specific experience requirements. Notwithstanding the color of the pilot's socks, should the insurer be required to provide coverage where the pilot's experience falls short of those requirements and the airplane crashes?

As careful drivers and attorneys who represent insurance companies, we would argue, "No, it shouldn't."

THE DEAL MADE

Some courts, like the California Supreme Court in cases like *Foster-Gardner Inc. v. National Union Fire Insurance Co.* (1998) and *Powerine Oil Co. Inc. v. Superior Court* (2001) have repeatedly taken a firm stand against rewriting unambiguous policy language to "create new coverage" and "impose new risks not assumed or paid for" by the contracting parties.

Along with the basic rule that a court must enforce unambiguous contract language, part of the rationale for this approach is that, as the California Supreme Court stated in *Foster-Gardner,* "judicially created insurance coverage leaves ordinary insureds to bear the expense of increased premiums necessitated by the erroneous expansion of their insurers' potential liabilities." Thus, even where enforcing policy language results in significant economic detriment to the policyholder, courts—consistent with general contract principles—will not rewrite a policy to improve the deal the policyholder made.

Some other courts, however, take pains to find coverage, even where a policyholder's action takes a risk outside what the policy insured. For example, in aircraft accident cases some courts determine that an insured's breach of a policy amounts to a mere "technicality," and then impose upon an insurer a "requirement" (not found in the policy) that the insurer establish a causal link between the insured's breach and the loss for which it seeks coverage.

A strong argument can be made that the approach requiring causation is contrary to the fundamental nature of insurance and the agreement struck by the contracting parties. After all, where an act takes the risk outside the defined coverage, requiring the insurer to provide insurance gives the policyholder an unbargained-for windfall.

TEXAS TAKES FLIGHT

An example of this mistaken approach can be seen as recently as Jan. 11, when the Supreme Court of Texas

rejected an appeal involving a helicopter accident for which an insurer denied coverage.

In *AIG Aviation Inc. v. Holt Helicopters Inc*., the helicopter's pilot did not meet the minimum experience requirements in the aircraft liability policy. The trial court ruled on summary judgment that, to avoid coverage, the insurer had to establish a causal link between the pilot's level of experience and the accident. The insurer was unable to do so at the subsequent jury trial.

The trial court awarded the insured $524,643, of which only $65,000 was compensation for property damage and the remainder was for attorney fees, interest, and penalties arising from the insurer's "unfair claim handling practices" in attempting to enforce the pilot-experience requirement in the policy.

The intermediate state appellate court affirmed, deciding, in accordance with the reasoning of the Texas high court in *Puckett v. U.S. Fire Insurance Co.* (1984), that enforcing the pilot-experience requirement would be contrary to public policy if doing so would void coverage. The court explained that the pilot-experience requirement was a "technicality" when it was not the cause of the loss.

The court concluded that, because the accident would have been covered but for the breach of the requirement, public policy required finding coverage to prevent the insurer "from obtaining a windfall by denying coverage for a risk it undertook to insure and for which" the policyholder paid.

Without issuing written opinions, the Supreme Court of Texas denied the insurer's petition for review and subsequent motion for rehearing.

Justice Don Willett, however, issued a strong dissenting opinion. Describing the "nontextual approach" as "starkly at odds with our insurance decisions generally" and most jurisdictions' "aviation-insurance decisions specifically," the dissent held that the court "should join the mainstream, not grant aviation contracts their own interpretive jet stream."

Perhaps reflecting an ideological divide on the court, Willett on the same day issued a lengthy dissent from a majority ruling in *PAJ Inc. v. The Hanover Insurance Co.* (2008), which held that, to avoid coverage, an insurer must show it was prejudiced by a policyholder's breach of a notice requirement in its policy, even where the policy does not require prejudice to be shown.

Lacking Inspection

The result in *Holt Helicopters* reflects a minority view. The majority view is represented by a 2006 opinion in which the Nevada Supreme Court, presented with a fact pattern similar to that in *Holt Helicopters*, conducted a searching analysis and concluded that unambiguous policy language precluded coverage where the accident aircraft did not meet the certification requirements in the owner's liability policy.

In *Griffin v. Old Republic Insurance Co.* (2006), the subject aircraft's airworthiness certificate was not valid at the time of an accident because no current annual inspection had been performed in accordance with Federal Aviation Administration regulations.

The court ruled that the policy's exclusion from coverage of a loss that took place when the aircraft had no valid airworthiness certificate was unambiguous and didn't require a causal connection between an aircraft's lack of airworthiness and the accident.

The court also concluded that public policy did not render the policy language unenforceable but decided that, to the contrary, public policy favors a rule that encourages aircraft owners and operators to satisfy mandatory federal safety regulations. Accordingly, the court refused to impose a causation requirement on the insurer.

The inconsistent results in *Holt Helicopters* and *Griffin* illustrate how the breach of a policy provision that establishes the scope of the insured risk presents a challenge to some courts.

Labeling such a breach a "technicality" allowed the Texas courts that decided *Holt Helicopters* to give short shrift to unambiguous policy language. They also ignored fundamental and well-established principles of insurance coverage. The breach at issue in *Holt Helicopters* was not a "technicality" because it was material to the insured risk—a pilot's qualifications and training are factors that determine the policy premium.

Moreover, the policies unambiguously stated that the insurer elected not to provide coverage for an accident that took place during a flight under prohibited circumstances, not because the flight was made under those circumstances.

Expanding the Risk

Although it is well established that courts will not rewrite unambiguous contracts to achieve a result more favorable to a party than it would have obtained under the bargained-for contract, the approach upheld in *Holt Helicopters* amounts to a judicial revision of the policy.

Where a policyholder flies its aircraft with a pilot who does not meet the policy's minimum experience requirements, the prohibited operation takes place outside the scope of the insured risk. If the insurer in *Holt Helicopters* had been willing to insure an aircraft operated by a pilot with less experience, it could have chosen to do so—in exchange for an appropriate premium payment. The Texas courts not only wrote into the contracts an unbargained-for causation requirement, they expanded the scope of the insured risk, ignoring the plain statement of that scope expressed in the policy language.

By focusing on the cause of the loss, courts that follow the minority Texas rule ignore the fact that parties to an insurance contract are free to agree that a policyholder's action that increases the risk of loss will result in no coverage.

The parties in *Holt Helicopters* made a contract reflecting a potentially greater risk of accident existing with a less experienced pilot at the controls. Unlike with the color of a driver's socks, the difference in the risk assumed was material to the bargain. Courts have no business changing that bargain after the fact.

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