

# **AIRCRAFT PHYSICAL DAMAGE**

## ***A Primer on Aircraft Insurance***

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### **The Total Loss**

In the following discussion, I will replot old ground. I may discuss a few things that you already know but with a different conclusion. You know that you have an agreed value policy form. But, how does this affect your claim settlement? Let's discuss it and other nuances found in your insurance policy.

An agreed value or stated value aircraft hull policy is one in which the value agreed to by the insured and the underwriter and shown on the declarations page (or the schedule of aircraft) of the policy is the amount that will be paid in the event of a total loss. It is also the amount that will be used in determining a total loss.

A typical policy definition states as follows: "Total loss means any physical damage loss for which the 'cost to repair' when added to the 'salvage value' (the value of the aircraft after physical damage and prior to repairs) equals or exceeds the Insured Value of the aircraft as set forth in Item 4 of the Declarations. Disappearance or theft of the entire aircraft shall be considered as a total loss." Other companies state: "Total Loss means physical damage for which the cost to repair equals or exceeds the insured value of the scheduled aircraft."

In more lenient times, although not specifically stated in the policy, if the cost to repair exceeded 70 percent of the insured value, the insurance company would assume the aircraft was a total loss. As shown above, this is not defined in the policy, but in practice, that is what a claimant customarily expected. In those times, you would expect a salvage bid of 30 percent on a 70 percent damaged aircraft. Therefore, we have a total loss.

Times have changed. During these recessionary years, due to the devaluation of aircraft, that custom has lost traction. Salvage is worth less and the companies have tightened their belts. To widen the gap, aircraft tend to be overinsured, increasing the importance of the salvage bid. The result is that the companies are attempting to repair significantly damaged aircraft rather than totaling them. They are sticking to the exact policy wording. When repairing an aircraft becomes the solution, especially one that is 70 percent damaged, several issues surface.

Repairs take time. This is time during which you are without the benefits of your aircraft. If it is a working aircraft, you will experience a loss of revenue. If the aircraft is used in your business for corporate transportation, it is back to the commercial airlines with you or the reliable company automobile. No, don't look for loss of use coverage under your aircraft hull insurance policy. It won't be there. At best, you may have a very small and limited amount of coverage under your extra expense coverage when or if it is available.

And then there is the "diminution of value" or the loss of value of the aircraft due to a damage history. To say that no one wants a wrecked aircraft is an understatement. Who would buy an aircraft with significant damage history, especially in a recession when similar aircraft are available at bargain prices that have no damage history? The price must be very cheap to attract a buyer.

So you keep the aircraft and use it. Are you really comfortable flying in a repaired aircraft that you know sustained significant damage? Maybe the repairs are very good and the aircraft is "better than new." There is still that head thing. You may never trust it again.

So, how much do you insure the aircraft for? If you overinsure the aircraft substantially and you have a loss that is 70 percent of the inflated value, who will offer a 30 percent salvage bid? By overinsuring your aircraft, you may have created a repair situation that would have been a total loss if the aircraft had been properly insured to value. In converse, if you substantially underinsure your aircraft, you could create a total loss when the aircraft could have been repaired. In this case, you would be offered a total loss claim check in the amount of the declared or stated value shown on your policy's declaration page. This was your pre-loss agreed value with your underwriter.

Thinking that you are saving money by underinsuring your aircraft may backfire by creating a total loss where a partial loss and repair would have been in the best interest of the insured.

What is the solution? There are several approaches. The best suggestion is to try to insure your aircraft for its true replacement value. This is the amount of money that you could replace your aircraft for in the open market. I am not talking about the "Aircraft Price Digest" (Bluebook) value. I am talking about the estimated cost to replace your aircraft in the current market. The best resource is a reputable aircraft dealer that specializes in your make of aircraft. Yes, the market value on your aircraft could move during your policy year. Chances are it won't move much during a policy year, right? Not so fast. If the "Aircraft Price Digest" is any indication, during our current recession certain aircraft have trended lower by as much as \$250,000 per calendar quarter. WOW!

During the soft aircraft market that we are currently in, you may want to revalue your aircraft every six months. Can you change your hull coverage during the policy year? You bet you can. You can call your agent and adjust your hull value at any time. Raise it if it is too low and lower it if it is too high. But let's be reasonable. I am talking significant numbers. Small fluctuations are inconsequential and not worth the call.

Of course, remember the banker. I have written in the past about alerting your banker to the devaluation of an aircraft hull especially if it drops below the amount you have financed. If you request that your agent order a hull reduction on your stated value policy, your underwriter will follow with a reissued certificate of insurance to your banker. Don't borrow trouble.

Should you change your hull value, it is logical that the premium will change as well. Increase your hull value and the premium goes up. Reduce it and the premium goes down. These adjustments are not always in proportion to the amount of the adjustment. The higher the premium the lower the hull rate per \$100 of value. The same works in reverse. I have discussed this many times, but it is always a point that is constantly questioned by the clients and friends whom we talk to.

If I don't like the policy definition of a total loss, can the policy be changed? Maybe. The only way to find out is to request an endorsement. Some insurance underwriters are willing to redefine the term "total loss." Some do not. If your policy's definition is too vague or not to your liking, you may want to request that a total loss is redefined as a loss requiring repairs of 70 percent or more of the insured value of the aircraft. In the event that your salvage is less than 30 percent of the value of the aircraft, you can still establish your claim as a total loss.

Wording such as: "The definition of Total Loss as shown in the Policy Definitions is deleted in its entirety and replaced with the following: Total Loss means any loss for which the cost to repair when added to the salvage value (the value of the aircraft after a loss and prior to repairs) equals or exceeds 70% of the insured value of the scheduled aircraft as set forth in coverage 13 of the declarations."

I am aware of an aircraft hull claim requiring repair costs of 80 percent of the insured value. Unable to obtain an adequate salvage bid, the insurance company elected to repair the aircraft. This evolved into a nasty situation. Unusual? Yes, but it happened.

In the event of a total loss on my aircraft, what will the settlement be? Will the insurance company try to find a similar aircraft to replace my total loss? No. As stated well in the following policy wording: "If the aircraft is destroyed, we will pay the agreed value of the aircraft less the applicable deductible. We will be entitled to ownership of the aircraft upon payment, free and clear of any encumbrances of the aircraft."

In short, you will receive a check for the amount of your aircraft value as stated on your declarations page minus any deductible.