AIRCRAFT BUILDERS COUNCIL NEWS

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President's Column

by **Timothy Carter**
President, ABC Board of Trustees

The year 2003 is an exciting time for our industry and for the Aircraft Builders Council. As our industry approaches the 100th anniversary of manned powered flight, the ABC is simultaneously approaching its 50th anniversary.

Both North Carolina and Ohio lay claim to the legacy of the Wright Brothers and have differing views as to who was "First in Flight." However, when it comes to being first in providing the aviation products liability insurance with limits and coverage that was vital to the growth and survival of the US Aerospace Industry, there should be no dispute. It was the insurance program put together by the Aircraft Builders Council that provided the risk protection that allowed our industry to grow and flourish.

Fifty years after the founding of the ABC, our industry faces serious challenges. Terrorism, world conflicts, SARS, and a global economic downturn have made for a difficult environment for most aerospace manufacturers. The ABC, however, is still coming through for its participants - with up to $1 billion in liability limits, broad and consistent policy form and additional services like the product integrity seminars and support offered by Mendes and Mount. Negotiations are currently in progress to increase the program limit to $1.25 billion on July 1, 2003.

In addition, at the Fall Conference, the ABC provides the world's most comprehensive forum for aerospace manufacturers to discuss risk issues and solutions. It provides a wonderful interface opportunity between underwriters, brokers, risk managers, and defense and general counsels to keep informed during these challenging times.

This year's conference will be held at the Ritz Carlton in Palm Beach, Florida on September 21-23, 2003. The program has been completed and will once again provide attendees with informational and educational sessions.

Please make sure you mark your calendars to join us for our special 50th Anniversary program in Washington D.C. on October 3-5, 2004. The program will be highlighted with a black tie gala event at the SmithsonianAir and Space Museum. You will see the history of aviation and the ABC come to life.

On a personal note, the ABC would like to thank Ellen Wiese for her dedication and service as the President for the past three years. Ellen, we thank you for the leadership and meritorious service you brought to the program.

Aircraft Builders Council 2003 Fall Conference

September 21-23, 2003

Ritz-Carlton, Palm Beach, Florida

Conference Registration & Program Information will be mailed soon!

Brokers' Report

by John H. Howes, Chair, London Brokers Committee & Martin McConnell, Chair, American Brokers Committee

The renewal of the ABC Program for the 2002/2003 year was accomplished in a market that had shown quite considerable powers of recovery in providing additional capacity compared with the previous year. The Program was renewed with an increased limit of up to $1 billion any one insured and continues to offer the same broad form coverage associated with the ABC, the only exception being the introduction of an asbestos exclusion. The renewal capacity was provided by the existing markets and some new markets which had not previously been involved with the ABC.

The number of insureds participating under the Program in 2001/2002 increased by some 20 per cent compared with the previous year and a similar growth pattern in new declarations under the Program for the 2002/2003 year has, to date, been sustained.

The aviation products liability insurance market continues to be influenced by the airline accounts. Following 9/11 both airlines and manufacturers paid substantially higher premiums at the first renewal date thereafter. More recently the airline account has been subject to considerable change in underwriting philosophy and we continue to see reductions of various sizes, especially on growing fleets with a good track record.

The products liability market has traditionally attempted to avoid the peak and trough premium trends experienced by the airlines market and are, therefore, likely to be slower to change. Small increases from 0 to 20 per cent are still being applied by the products market. However, there are signs of a softening of this trend and it is quite likely that despite the products liability loss ratios, some movement in the rating levels will occur prior to the renewal of the ABC Program at 1 December. Obviously, a great deal depends on the aerospace loss record but if the loss pattern remains relatively stable, and there are no extraordinary losses affecting the ABC, it is relatively easy to visualize a fairly flat market on good accounts, taking into consideration the likely down-sizing of the aerospace manufacturing industry.

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The aviation insurance industry in general faced a number of problems during the latter part of 2002 and the early part of 2003, especially relating to TRIA and to some extent the Homeland Act. Although the products liability market was not directly affected, the situation regarding TRIA made it imperative that underwriters offer aerospace insureds full terrorist coverage up to their full policy limit, to comply with the requirements of the Act, including the ability to avail themselves of the reinsurance protection from the US Government in the event of a defined act of terrorism taking place. TRIA is undoubtedly limited in its coverage and the additional premiums being charged were usually the same amount again as the annual premium. It must be said that it is difficult to understand manufacturer's liability to terrorism and, as a consequence, many manufacturers have chosen not to buy the much broader form write back provided under AV52F for a reduced limit of $50 million.

At the time of writing the ABC Program continues to attract new insureds and as we move to the 50th year of the Program, the founders of the original Program would be justifiably proud of an industry facility which has survived the test of time. There is little doubt that the value of the Program to the industry has been immense and at various times during its history has proven to be the only available market able to provide coverage for sub-contractors to the aerospace industry.

We believe that the future of the Program is assured in the hands of a number of competent markets together with the guidance given by the all important Board of Trustees.

Mendes & Mount Report

by Garrett J. Fitzpatrick, Esq.
Partner in the Law Firm of Mendes & Mount, New York

Recent Legal Developments

1. GOVERNMENT CONTRACTOR DEFENSE

In the ABC Law Report published last fall, we submitted an article on a significant extension of the government contractor defense to services related to the maintenance and overhaul of military aircraft. Our office represented DynCorp in two separate actions filed in the United States District Court for the Northern District of Alabama arising out of the same accident on May 1, 1999 involving a U.S. Army UH-1 ("Huey") helicopter which crashed in Alabama while on a medivac mission. The crash resulted from a separation of the vertical tail fin from the helicopter, and both the pilot and co-pilot were seriously injured. Two separate personal injury actions, *Hudgens v. DynCorp* and *Crawford v. DynCorp*, were then filed in the U.S. District Court for the Northern District of Alabama.

DynCorp had a contract with the U.S. Army to inspect and maintain the helicopter fleet at Fort Rucker, Alabama, and this work was to be performed pursuant to the Army Technical Manuals. The evidence in this litigation also demonstrated that DynCorp did not have the authority, and it was contractually prohibited, from performing any maintenance or inspections on the helicopter fleet which were not specifically called for in the Technical Manuals. On behalf of DynCorp, we subsequently moved for Summary Judgment based on the government contractor defense and, predictably, plaintiffs argued in opposition to our motion that the government contractor defense did not apply to performance or service contracts but rather was limited to alleged design defects in the procurement/manufacturing environment. At the District Court level in both the Hudgens and Crawford cases, both Courts held that the government contractor defense would apply to maintenance/service contracts with the military and, having decided this threshold issue, the Courts further held that DynCorp met the three prong test of (a) the Army approved reasonably precise specifications for maintenance (b) DynCorp fulfilled its contractual obligations under the service contract and (c) DynCorp was not aware of any dangers that were unknown to the Army.

Both plaintiffs thereafter filed their Appeals with the United States Court of Appeals for the Eleventh Circuit. We are pleased to advise that on April 25, 2003, the Eleventh Circuit rendered an opinion affirming the summary judgments in favor of DynCorp. The Eleventh Circuit, following the rationale for this defense as set out in the leading U.S. Supreme Court Decision of *Boyle v. United Technologies*, held that "although Boyle referred specifically to procurement contracts, the analysis it requires is not designed to promote all-or-nothing rules regarding different classes of contracting. Rather the question is whether subjecting a contractor to liability under State Tort Law would create a significant conflict with a unique federal interest." Significantly, the Eleventh Circuit went on to hold that "the formulation of design specifications and the articulation of maintenance protocols involved the exercise of the very same discretion to decide how a military fleet of airworthy craft will be readied. Holding a contractor liable under state law for conscientiously maintaining military aircraft according to specified procedures would threaten government officials' discretion in precisely the same manner as holding contractors liable for departing from design specifications." Having affirmed the application of the government contractor defense to the maintenance/service contract area, the Eleventh Circuit then found that DynCorp satisfied the three elements of the defense set forth by the Supreme Court in Boyle.

This is an important decision that will materially impact the liability exposure of many companies involved in the maintenance and servicing of military aircraft, particularly with an affirmance at the Federal Circuit Court of Appeals level.

2. U.S. SUPREME COURT RULING ON PUNITIVE DAMAGES

The United States Supreme Court in *State Farm Mutual Automobile Insurance Co. v. Campbell et al.* has now rendered a further opinion on the subject of punitive damage awards, and to provide additional guidance to the Lower Courts on their instructions to juries on punitive damages and when the amount of such awards can exceed the bounds of due process.

Curtiss Campbell caused an accident in which one person was killed and another permanently disabled. His insurer, State Farm, declined to settle the resulting claims for the $50,000 policy limit, took the case to trial and a jury thereafter determined that Curtiss Campbell was 100% at fault and returned a verdict for over three times the policy limits. Thereafter, State Farm did not appeal the verdict, and Campbell then pursued an appeal with his own counsel, and the appeal was denied. The Campbell's then sued State Farm for bad faith, fraud and intentional infliction of emotional distress.

At the trial court level, the jury awarded $2.6 million in compensatory damages and $145 million in punitive damages which the trial court reduced to $1 million and $25 million respectively. In the ensuing appellate process, the Utah Supreme Court reinstated the $145 million punitive damage award. The United States Supreme Court then granted certiorari to again address the subject of punitive damages.

In reversing the Utah Supreme Court, and remanding this matter for further proceedings, the U.S. Supreme Court first reconfirmed the three "guideposts" for reviewing punitive damage awards as promulgated in the earlier U.S. Supreme Court decision in *BMW of North America v. Gore*. These "guideposts" include the following: (1) the degree of reprehensibility of the defendant's misconduct, (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

Of particular significance in the Campbell decision, the Supreme Court revisited the subject of "ratios" between the amounts of compensatory and punitive damage awards in a particular case. In Campbell, the Court stated "while these ratios are not binding they are instructive. They demonstrate what should be obvious: single-digit multipliers are more likely to comport with due process, while still achieving the State's goals of deterrence and retribution, than awards with ratios in range of 500-1 or, in this case, of 145-1."

The Campbell decision should provide further guidance to the trial courts on the subject of punitive damages, instructions to the jury and post-verdict review of these awards.

Lead Underwriters' Column

by Graham Daldry, ACE Global Markets Limited
& Martin Cox, Global Aerospace Underwriting Managers

Following the recent swings in premium levels the aviation products insurance market seems to have now regained a state of equilibrium. It is widely reported that underwriters require in excess of $1bn in income for aviation products liability income. Recent estimates put the current figure at around $800-850m, so it is clear that there still needs some adjustment. There are various factors that will affect this requirement.

Firstly, aviation underwriters are faced with a market of reducing spread of risk with now only two major airframe manufacturers and the numbers of major component makers reducing annually at an alarming rate. This may be good for the industry but for insurance underwriters this results in a lack of spread that is so necessary for the correct calculation of premium.

Secondly, underwriters today are subject to more rigorous reporting procedures and analysis than ever before. This is not necessarily a bad thing and does assist in identifying trends and business issues quicker than previously. Long tail liability is the most difficult to assess for obvious reasons. Aviation insurance does not lend itself to trend analysis that well in the long term as whilst the number of major accidents is within a certain band (20-25 western built jet total losses annually) assumptions as to whether the aircraft are aging and low valued cargo aircraft or state of the art fully loaded passenger aircraft are unforeseeable. Furthermore, the cost of these accidents over time is very hard to accurately assess with such imponderables as speed of settlement and value of claim fluctuations as well as prediction of future economic conditions almost impossible to get right. Premium levels therefore need to achieve a "comfort level" at which underwriters can be confident of being profitable.

It is arguable that the two major manufacturers do not fit into a "book" of business and therefore must stand-alone and should create an underwriting profit to insurers. To put them into the products liability premium totals completely skews the figures where they have been responsible for a quarter of the premium income and an increased proportion of the claims. This amount of premium also distorts the figures for the rest of the book creating a false higher figure for income on a long tail account

With income levels as they are there is also the opportunity for underwriters to increasingly differentiate risks from one another. This has been shown in renewal rating which is difficult for observers to generalise on. Averages do not tell the whole story and risks are being treated on an individual basis. As stated above there is a low spread of risks within the aviation products market and therefore the rules applying to markets with large pools to draw on do not apply.

In conclusion, overall premiums need to continue to rise although not necessarily in such large fluctuations as recently, underwriters need to show capital providers a fair return on their investment and lastly, risks are being very much assessed on their own merits that can only be good for our clients.

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