

Turbulence Ahead For Commercial Drone Insurance

Law360, New York (March 1, 2016, 3:53 PM ET) --

In the not too distant future, seeing birds, planes and “super” drones soaring across the sky will be a commonplace occurrence across the U.S. The interest in and use of commercial drones — also referred to as unmanned aircraft vehicles (UAV) or unmanned aircraft systems (UAS) — is skyrocketing despite the many potential insurance liability and coverage issues on the horizon.

Companies like General Electric Co. are currently engaged in pilot projects exploring the use of drones to inspect power lines. Real estate agents and filmmakers are utilizing drones to capture aerial film and photographic images that would not be accessible or otherwise possible with standard equipment. Farmers are employing drones to survey and manage land, crops and livestock. In 2015, Amazon received approval from the Federal Aviation Administration (FAA) to test drones for delivery services.



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Even insurers are taking to the airways and employing drones in their own underwriting and claims-related activities. American International Group Inc., State Farm Automobile Insurance Co. and United Services Automobile Association recently received limited approval to use drones to conduct inspections in the U.S. In a 2015 survey by Munich Re, corporate risk managers stated that they believe the use of drones could become common practice for almost 40 percent of businesses within the next five years.

Under federal law, all drones are required to be registered with the FAA. In accordance with Section 333 of the FAA Modernization and Reform Act of 2012, any individual or entity that intends to use drones for nonhobby or recreational purposes (i.e., commercially) must petition for an exemption. The number of drone petitions granted by the FAA has increased exponentially over the past several years. As of 2012, the FAA had granted just several hundred permits. In 2015, the number of permits had grown to over 1,000. And, as of February 2016, the FAA has granted over 3,500 permits to companies seeking to incorporate drones into their business activities. The FAA estimates that 7,500 commercial drones may be in use by 2018.

Potential Insurance Coverage and Policy Issues

The upsurge of drones in the sky will invariably increase liability risks and attendant insurance coverage issues. Within the past few years, an unidentified drone came close to colliding with a landing plane at London Heathrow airport; a woman was hit in the face by a drone causing facial abrasions in a restaurant; and a California Highway Patrol helicopter had to veer away from a drone in order to avoid a

collision. In an FAA report released in December 2015, there were 241 reports of near-collisions between drones and manned aircrafts between December 2013 and September 2015 in the U.S.

A typical commercial general liability policy includes an exclusion under Coverage A (bodily injury and property damage) for the ownership, maintenance, use or entrustment to others of aircrafts. Coverage B (personal and advertising injury) generally does not include an aircraft-related exclusion. "Aircraft" is not defined in the standard CGL coverage form. The FAA Modernization and Reform Act of 2012 defines a drone as "an aircraft that is operated without a possibility of direct human intervention from within or on the aircraft." The Merriam-Webster definition of "aircraft" is "a machine (such as an airplane or a helicopter) that flies through the air."

In view of federal law and the common sense understanding of the term aircraft, the use of a drone should be excluded under the traditional "aircraft" exclusion in a CGL policy. However, it is not difficult to imagine a creative policyholder raising arguments in support of coverage. While a drone is defined as an aircraft under federal law, the definition of drone for regulatory purposes may not be binding in terms of the legal interpretation of an insurance policy. Arguments in favor of coverage also may include that the aircraft exclusion is ambiguous due to the term being undefined and, therefore, should be interpreted against the insurer. A policyholder could also potentially argue that the aircraft exclusion should be narrowly construed in favor of coverage because, despite its plain meaning, it is intended to apply only to manned aircrafts and not drones.

Commercial drone use may also trigger invasion of privacy, copyright infringement, trespass and other personal and advertising injuries under Coverage B, which does not typically include an aircraft exclusion like Coverage A. One of the major commercial uses of drones presently is data collection. In various industries, drones are equipped with cameras and other data collection devices. For example, companies using drones may inadvertently capture trade secret or other private information that could pose significant privacy risks and consequent insurance liabilities.

Because courts have yet to define drones and determine whether they constitute an aircraft for purposes of the aircraft exclusion in traditional CGL policies, insurance coverage remains unresolved. Based on the rapid development in commercial drone technology, it is likely that courts and insurers alike will soon face increasing drone-related insurance coverage disputes.

New Policy Endorsements

In response to the recent proliferation of commercial drone use, the Insurance Services Office Inc. (ISO) released several optional endorsements to address liability exposure related to drones, effective June 1, 2015. Six endorsements were introduced to supplement standard CGL and commercial umbrella and excess policies. Three liability exclusion endorsements were added that specifically exclude drone liability under Coverage A only, Coverage B only, or Coverage A and B under a single endorsement. The exclusionary endorsements exclude liability arising out of the ownership, maintenance, use or entrustment to others of any drone, including operations, loading and unloading. The new ISO endorsements also include three coverage endorsements, which provide limited coverage under Coverage A only, Coverage B only, or Coverage A and B for drones described in the endorsement schedule but only with respect to operation(s) and project(s) also described in the schedule.

Each of the new ISO endorsements adds a definition of "Unmanned Aircraft" to the definitions section in the endorsements. "Unmanned Aircraft" is defined as an "aircraft that is not: (1) designed; (2) manufactured; or (3) modified after manufacture; to be controlled directly by a person from within or

on the aircraft.” The new ISO optional endorsements serve the dual purpose of clarifying existing coverage under standard CGL policies, and also offering policyholders the ability to add coverage for drone-related activities and operations. Because the endorsements were only implemented in June 2015, whether they will be widely incorporated by insurers into their products has yet to be determined.

Drone-Specific Insurance Policies

In addition to the ISO optional endorsements for standard CGL, commercial umbrella and excess policies, some insurers have started to offer drone-specific policies. Companies such as AIG, Berkley Aviation and Global Aerospace now offer drone-specific policies and other applicable endorsements that permit policyholders to customize coverage for those who operate, or utilize the services of drones for their businesses. In general, these policies include language specifically geared towards responding to exposures arising from drones. Policies may provide coverage and/or optional endorsements for first and third party liability, losses arising from electronic malfunctions and failures and physical damage to the aircraft and ground control units. Coverage may even extend to war, hijacking and terrorism liabilities.

Commercial drone insurance is a relatively new type of insurance coverage, with only a limited number of companies currently offering drone-specific products. The lack of historical and analytical data poses significant underwriting challenges for insurers. Relatedly, there are still a number of open ended issues in terms of determining risk profiles and accessing liability exposures in order for insurers to successfully underwrite and price drone-specific policies. With the growing number of companies seeking to incorporate drones into their business activities, and the uncertainty of coverage for drones under standard CGL policies, more companies are likely to seek drone-specific policies or endorsements going forward.

Where To From Here?

The potential applications for drones seem limitless and many industries are already using or intend to use drones in the future. As the number of drones used for commercial purposes continues to soar, so does the likelihood of collision and other liability risks. Given that the use of drones commercially is still at the beginning stages, it is a perfect time for insurers to clarify coverage under standard CGL, commercial umbrella and excess policies and also to consider offering drone-specific policies and endorsements.

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