

Dawn of the Drones—A New Era of Insurance Coverage Issues

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Drones, or unmanned aerial vehicles (UAVs), promise to revolutionize not just commerce but the insurance markets as well. In 2014, the European Commission estimated that, within 10 years, UAVs will represent 10% of the global civil aviation fleet. The United States Federal Aviation Administration (FAA) estimated in April 2015 that in eight years annual global spending on unmanned aircraft will total US\$11.5 billion. According to recent predictions, more than one million UAVs may be in commercial operation in 2015 in the United States alone. While we await promulgation of regulations governing their use, drones can be found on the shelves of your local technology store.

As with past waves of innovation, business will look to insurance to facilitate innovation and protect against risks. The marketplace has shown that the demand for appropriate insurance to guard against these risks exists—now.

Background on Drone Insurance Coverage

The insurance industry has provided some drone or UAV coverage as far back as the late 1980s. Commercial uses of drones today include a wide variety of exciting applications, including use of drones in package delivery, agriculture, crop protection and aerial photography. Indeed, the insurance industry itself has found drones useful in conducting claims investigations, and insurers, awaiting regulations by the FAA, have provided coverage after writing their own safety rules for insureds to follow.

The insurers that have jumped most quickly into the market for insuring UAVs are those traditionally involved in the manned vehicle or aviation insurance sectors. Insurers like Global Aerospace, AIG and Lloyd's of London are supporting this nascent industry despite a lack of underwriting data and understanding of the risks. As reported by Bloomberg in March of this year, U.S. companies have obtained insurance coverage from insurers that have, in effect, regulated the use of drones by writing their own underwriting or safety rules for such policyholders. Thus, at a time when the FAA publicly predicts that its final regulations governing the use of UAVs are more than two years in the future, several U.S. insurers are already issuing policies insuring thousands of drones across the country.

What Risks Can Be Covered?

At this writing, “drone insurance” applies to risks from either physical loss or liability from third-party claims.

Coverage for Loss of Property: Insurance coverage for physical loss will apply to protect a policyholder from first-party risks of loss, including damage to the UAV itself or its cargo, equipment, ground station or control unit. The primary debate about such coverage focuses on whether the insurance should pay for an “agreed value” or an “insured value.” Under a policy covering an agreed value, the insurance, at the time of loss, pays the previously agreed upon value of the UAV, less applicable deductibles. In contrast, a policy promising to pay the insured loss pays an amount of loss that reflects the perceived value of the UAV at the time of the loss.

Coverage for Liability: As shown by recent news reports of UAVs going awry, another primary exposure is the risk of liability for costs of defense and settlements or judgments payable to third-party claimants. Third-party liability insurance protects against liability for an injury or damage to the persons or property of third parties, and against liability for products manufactured, sold or distributed by the policyholder. Concern has arisen over the possibility that unregulated drones could cause significant losses by bringing down or interfering with commercial or other aircraft.

Coverage for Privacy and Breach Claims: Less obvious are the risks of claims for breach of privacy. With some drones as small as insects, the risk of privacy-related claims is something to consider. Indeed, in contrast to coverage sold even last year, insurers selling traditional commercial general liability (CGL) insurance today generally exclude coverage for such claims. Those underwriters worry that providing insurance for such exposures may present a “moral hazard,” and thus might undermine the traditional requirement that the injury from a loss be unexpected. Investigating such losses could prove difficult. The majority of UAVs in use today operate in the same frequency as that used by domestic Wi-Fi devices. The question that then arises is whether UAVs could, for example, be used to hack into technology guiding the flight path of an aircraft. Engineers have demonstrated that malware attacking drones, sometimes called “maldrone,” could be used to hack into software used by drones, changing, for example, the flight path and the destination programmed into the drones.

The Insurance Industry Response

On June 1, 2015, the Insurance Services Office, Inc. (ISO), an insurance industry trade group in the United States, issued policy provisions to address the growing liability exposures posed by the commercial use of drones. These new ISO provisions modify coverage provided under ISO’s standard commercial general liability (CGL) and umbrella/excess liability policy forms. ISO has issued three optional exclusions and three coverage endorsements that commercial insurers can use to address a range of potential exposures from bodily injury, property damage and other potential liabilities from the use of UAVs.

Recommendations for UAV Insurance Coverage

The new coverage provisions were approved for use as of June 1, 2015. They merit close consideration by policyholders. As with any new insurance provisions, they are untested. Policyholders should review these provisions carefully in light of their entire insurance program and should consult with their insurance advisors to ensure that these untested provisions provide the kind of protection the policyholder seeks.

Companies using UAVs may also look to the traditional aviation insurance market for coverage and should also consider cyber coverage and the protection it promises for privacy and data-breach exposures.

This new era of unmanned aerial technology promises exciting benefits. However, policyholders should carefully review their exposures—and any of these new, or modified, insurance products that promise to provide protection for such risks. Policyholders would be well advised to consult with their insurance advisors to ensure that these untested provisions provide the kind of protection the policyholder seeks.

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