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ALERT

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EIGHTH CIRCUIT APPLIES COMPULSORY INSURANCE DOCTRINE TO SAVE NORTHWEST: WHAT WILL SAVE YOU?

By Barry S. Alexander and Lee C. Schmeer

The Eighth Circuit Court of Appeals recently handed down a decision in *Northwest Airlines, Inc. v. Professional Aircraft Line Serv.* that, although unique in its specific facts and holding, highlights the problems that may arise when one party to a contract is required to cover the liability of the other party, whether through indemnity or insurance, or both.[1] The specific issue in dispute in this case was whether Westchester Fire Insurance Company ("Westchester") was liable directly to Northwest Airlines ("Northwest") under a policy of insurance issued by Westchester to Professional Aircraft Line Service ("PALS"), a maintenance provider, for damage to a Northwest aircraft caused by PALS's negligence. Westchester contended that PALS's failure to provide timely notice of claim as required by the policy precluded coverage to Northwest. Applying the compulsory insurance doctrine, the Eighth Circuit held that because the hangarkeepers insurance implicated was required by local law, Westchester was liable directly to Northwest notwithstanding PALS's failure to provide timely notice.

[1] *Northwest Airlines, Inc. v. Professional Aircraft Line Serv.*, No. 13-1754 (8th Cir. Jan. 14, 2015).

The Underlying Incident and Insurance

Incident. The underlying action arose out of $10 million in damages ($7 million for physical damage and $3 million for loss of use) alleged to have resulted when a PALS employee failed to set the parking brake on a Northwest aircraft at McCarran International Airport in Las Vegas, Nevada, causing the aircraft to roll uncontrollably until it came to rest at the bottom of an embankment.

Insurance. Clark County, where McCarran Airport is located, has in place a compulsory insurance ordinance relating to the airport that required PALS to obtain hangarkeepers insurance coverage of at least $5 million. Moreover, PALS's contract with Northwest required that PALS maintain at least $25 million of commercial general liability insurance, including hangarkeepers liability coverage. PALS obtained $5 million in hangarkeepers coverage from Westchester. Pursuant to the insurance policy, PALS was required to provide notice to Westchester "as soon as practicable" of any claim against the company.

The Underlying Actions

Northwest's Action Against PALS. Northwest commenced litigation against PALS in Minnesota state court to recover for its damages. PALS did

not respond to the complaint, and a default judgment was entered for $10 million.

Westchester's Declaratory Judgment Action and Appeal. Westchester subsequently filed a declaratory judgment action in the United States District Court for Nevada against PALS seeking a declaration that it was not required to provide coverage to PALS for Northwest's claim due to PALS's failure to provide timely notice. Northwest intervened in the action, but PALS did not appear. The district court ultimately granted Westchester's motion for a default judgment and held that PALS was not obligated to pay the loss. The district court also bound Northwest to the judgment.

On appeal, the Ninth Circuit vacated the judgment and remanded, holding that Northwest could not be bound by PALS's failure to defend itself. On remand, the district court held that Westchester was not liable to PALS, but declined to decide whether Westchester could be held liable directly to Northwest, instead advising Northwest to file a direct action against Westchester.

Northwest's Direct Action Against Westchester. Northwest followed the district court's advice, and filed an action against Westchester in Minnesota state court. The case was removed to federal court in Minnesota, and Westchester argued that it could not be held liable to Northwest because PALS, its insured, failed to provide timely notice of the claim.

The district court, applying Minnesota law, concluded that the Clark County ordinance requiring hangarkeepers insurance was aimed at protecting parties like Northwest, and given that purpose, Westchester could not avoid its obligation to Northwest based on its insured's failure to "satisfy the technical post-loss conditions on his statutorily mandated coverage."

On appeal, the Eighth Circuit acknowledged that the case was a "close call," yet held that the purpose behind the compulsory insurance ordinance trumped the insurer's attempts to avoid its application. The Eighth Circuit explained that under the compulsory insurance doctrine, "'[i]n the case of liability policies issued pursuant to, and in compliance with, compulsory insurance or financial responsibility statutes, the rule followed generally is that the injured person is not subject to defenses arising out of the breach of conditions subsequent to the accident even though they would be available to the insurer against the insured.'" Northwest, thus not being subject to Westchester's notice of claim defense against PALS, was entitled to coverage for the default judgment up to the $5 million limit of the policy.

Guidance for the Aviation Industry

Admittedly, the facts and law applied in this action are somewhat unique. The decision resulted from a rarely invoked doctrine of law (in fact, the court stated that there was no case directly on point under Minnesota or Nevada law). Nevertheless, this action is one of many that point out the difficulties that can arise out of contractual indemnity and insurance provisions. In this case, the problems for Northwest arose out of PALS's failure to satisfy its obligations under the insurance policy, and there probably was little Northwest could have done to prevent this protracted litigation other than to take a more active role in pushing PALS to provide notice to its insurer or to promptly contact the insurer itself.

In many other cases where disputes arise from contractual liability/indemnity and insurance provisions, a dispute might easily have been avoided. For example, in *In re Deepwater Horizon,* No. 13-0670 (Tex. Sup. Ct.), BP, Transocean (the owner of the well) and Transocean's insurers are awaiting the Texas Supreme Court's decision on whether BP is an additional insured for as much as $750 million in coverage obtained by Transocean. Six party and seven amicus briefs, one of which we filed on behalf of the Aviation Insurance Association, were filed on issues that arose out of imprecise contract and insurance policy language, and one side is going to be disappointed to the tune of nearly $1 billion.

Indemnity and additional insurance provisions are common in the aviation industry, and major losses with exposures in the hundreds of millions of

dollars are an unfortunate reality. Nevertheless, all too often, too little attention is paid to the wording of contracts and insurance policies. Insureds and insurers alike could be well served by increased attention to contractual indemnity and additional insured provisions, and related insurance policy language, which in certain instances could require an analysis of the applicable law. A few dollars spent early on could save tens of thousands, and sometimes hundreds of millions, of dollars later on.

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