SPRING 2006

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Insurance Observer

REDUCED EXPOSURE FOR AUTOMOBILE RENTAL AND LEASING COMPANIES: MAYBE OR MAYBE NOT?

Stephen R. Moore

Introduction

On a warm summer night in 1997, a woman in her early twenties and her friend accepted a ride from two young men they had met in a bar that evening. Unfortunately, the young man who was driving was impaired. He lost control of his car on a curve on a dark country road, rolled the car in the ditch, and the young woman was ejected from it. She sustained devastating injuries. The driver had leased the car from the leasing subsidiary of a major automobile manufacturer.

The young woman sued the driver and the leasing company. The young man carried $1 million of third party liability coverage, as required by his lease. His insurer paid out that $1 million early in the litigation. We acted for the leasing company's insurers and settled the claim in the fall of 2005 for just under $10 million plus costs. This settlement received significant press coverage. It was reported that this was the largest motor vehicle accident settlement in Canadian history.

Shortly after this settlement was announced, meetings were arranged between representatives of the leasing industry, the car rental industry, and the Ontario Government. The purpose of those meetings was to convince the government to change the vicarious liability rules for leasing and rental companies. The leasing industry argued that a lease was simply one of several methods of financing the acquisition of a car. It contended that lessors should not be exposed to unlimited liability simply because the vehicle continues to be owned by the leasing company under this form of financing. The government listened, and on March 1, 2006, the rules for vicarious liability for leasing and rental companies changed significantly.

However, no changes have been made to the automobile insurance policies which insure rental and leased vehicles. Without changes to these policies, the insurers of leasing and rental companies may well be obliged to cover the negligence of operators and lessees. From the perspective of the insurance industry, it may turn out that nothing has changed.

The New Regime

The government had to choose between two methods to resolve the concerns of the leasing and rental companies. It could make the lessee or renter solely liable for negligence of those who operated the leased vehicle and relieve the owner of any liability. Alternatively, it could make both the owner and lessee or renter jointly liable but cap the owner's exposure. Several provinces, including British Columbia, do not impose any liability on lessors.

The Ontario government rejected the B.C. approach and chose to make both the owner and the lessee or renter jointly liable and cap the owner's liability. In addition, the Ontario reforms make the lessee or renter's automobile insurance policy primary and the owner's excess. While there was little surprise that the Ontario government moved to ameliorate the situation of leasing companies, we were surprised that these reforms were applied to short-term rentals.

INSURANCE OBSERVER

Stephen Moore, a partner with Blaney McMurtry LLP since 1988, practices mainly in the insurance field. His main areas of focus are automobile accident related personal injury defence, automobile coverage and insurance claims and he is recognized inside and outside the profession as an expert on Bills 59 and 198, the parts of the Insurance Act that deal with Ontario's Motor Vehicle Tort Compensation system.

Stephen may be reached directly at 416.593.3950 or smoore @blaney.com

The new regime is contained in a series of amendments to the *Compulsory Automobile Insurance Act*, *Highway Traffic Act*, and the *Insurance Act*. The Bill containing these amendments was passed in December of 2005 and was proclaimed in force March 1, 2006.

The basic scheme of the new regime is fairly easy to understand. However, we anticipate that there may be some unanticipated results when this scheme is applied in some situations. We will return to those potential problems after outlining the basic scheme.

The definition of "lessee" in section 192 of the *Highway Traffic Act* has been amended. A lessee is now defined as "a person who leases or rents a motor vehicle or street car for *any period of time*" [emphasis added]. From this point forward I will use the term "lessee" to describe true lessees and renters. Another amendment makes a lessee liable, in the same manner as an owner of such vehicles, for any loss or damage caused by the negligent operation of the vehicle. The liability of the owner, operator, and lessee is explicitly stated to be joint and several. It appears that they are jointly and severally liable to plaintiffs, but it is unclear what their liability is to each other.

The details of the scheme are set forth in the amendments to the *Insurance Act*. These amendments only apply to claims for bodily injury or death. Accordingly, an owner is still fully liable for any property damage caused by vehicles it owns. For bodily injury and death claims, the liability of the owner is essentially capped at $1 million less any insurance that the lessee or operator of the vehicle has available to respond to the claim. If such other policies exist, then the lessee's policy responds first, the operator's policy responds second, and the owner's policy responds third. This scheme does not apply to motor vehicles that are used as taxicabs, livery vehicles, or limousines for hire. The $1 million maximum liability of the owner can be modified by regulation (there are currently no regulations) or by a provision in another act or regulation obliging that vehicle to carry higher minimum limit of liability coverage (for example, the liability of the lessor of a bus would be $8 million as required by the *Public Vehicles Act*). These amendments only apply to the vicarious liability of the owner. If the owner was itself negligent these provisions do nothing to reduce the owner's liability for such negligence.

After March 1, 2006, the following would not be an atypical situation involving the negligent operation of a leased vehicle. The leased vehicle is owned by Leaseco, leased by John Lessee and operated at the time of the accident by Tom Driver. John Lessee has insurance of $1 million which names Leaseco as the lessor of the vehicle. Tom Driver also has insurance on his own vehicle with limits of $1 million. If the plaintiff's damages are assessed at $2.5 million, then $1 million will be paid out under John Lessee's policy. That payment will reduce Leaseco's exposure to zero subject to the comments I will make below regarding insurance. Tom Driver's policy will then pay the next $1 million of the judgment. That will leave a shortfall of $500,000.00 for which John Lessee and Tom Driver are jointly and severally liable to the plaintiff. It is unclear whether John Lessee would have any right to indemnity from Tom Driver in respect of this personal liability.

Finally, amendments to the *Compulsory Automobile Insurance Act* requires persons renting or leasing vehicles for periods in excess of thirty

days to be able to demonstrate that the leased or rented vehicles are insured under automobile insurance policies.

What Vehicles Are Subject to The Legislation

The amendments to the *Highway Traffic Act* change the definition of lessee as outlined above. These changes apply to any vehicle that falls within the definition of "motor vehicle" in the *Act* and to street cars. The *Act* defines "motor vehicle" as follows:

> includes an automobile, motorcycle, motor assisted bicycle unless otherwise indicated in this Act, and any other vehicle propelled or driven otherwise than by muscular power, but does not include a street car, or other motor vehicles running only upon rails, or a motorized snow vehicle, traction engine, farm tractor, self-propelled implement of husbandry or road-building machine within the meaning of this Act.

The *Compulsory Automobile Insurance Act* applies to motor vehicles as that term is defined under the *Highway Traffic Act* together with trailers, accessories and equipment of a motor vehicle and deems streetcars to be motor vehicles. Accordingly, the amendments under both acts apply to essentially the same vehicles.

For some unknown reason, the definition under the *Insurance Act* does not appear to cover street cars. Accordingly, any entity leasing or renting streetcars is not subject to the amendments limiting the liability of owners and re-arranging the priority of insurance policies.

It is also clear that these provisions do not apply to any vehicle that explicitly falls outside the definition of "motor vehicle" in the *Highway Traffic Act*. This would include, for example, leased snowmobiles, leased farm tractors, and road-building machinery.

The Insurance Problem

Rental and leasing companies have traditionally arranged their insurance in a manner designed to limit any excess coverage they carry to the rental or leasing company. The policies are designed so that they do not extend any excess coverage to the operator or lessee of the vehicle.

The approved excess automobile endorsement (S.P.F. 7) would extend excess coverage to all entities insured under the primary O.A.P. 1 policy. Normally, this would be the rental and leasing company and the operator and other occupants of the vehicle. To avoid this result, many rental and leasing companies do not use the standard S.P.F. 7, but rather extend coverage to leased and rented vehicles by way of a special endorsement on their C.G.L. or umbrella policy. This endorsement makes it clear that the coverage is for the owner of the vehicle only.

The recent Court of Appeal decision in *Avis v. Certas* may have robbed this approach of its vitality. That decision, which interpreted an umbrella policy issued by an out of province insurer which had filed a protected defendant undertaking, concluded that the umbrella policy provided coverage not only to the rental company, but also to the occupants of the rental vehicle.

If the excess insurance arranged by the rental or leasing company is obliged to provide coverage to the occupants of the automobile, then the limitation on the vicarious liability of the rental or leasing company may be of no practical utility to the insurance industry. It does not appear that any thought has been given to creating a lessor's version of the S.P.F. 7 that gives effect to the intentions of these amendments. We would also have thought that the S.P.F 8 (lessors contingent automobile endorsement) would have been amended in a similar manner.

Additional Comments

As discussed, we are surprised that the legislation was implemented without the Financial Services Commission of Ontario first making some changes to several standard automobile insurance policies.

We anticipate problems with short term rental vehicles. Renters will probably be offered optional liability coverage, but will have no idea whether they should or should not purchase this coverage. The only advice that they will receive will come from rental company employees who are not licensed to sell insurance. Depending on how rental companies arrange their insurance, renters could be taking big risk by not buying such optional coverage.

The final comment we would like to make concerns a potential ambiguity in the drafting of one of the amendments. Earlier, we stated that in determining the liability of the lessor one deducts the lessee's third party liability limits from the lessor's maximum liability (generally $1 million). However, the actual wording requires the deduction of any amounts

> that are recovered for loss or damage from bodily injury or death under the third party liability provisions of contracts evidenced by motor vehicle liability policies *issued to persons other than a lessor* (emphasis added)

There is an argument that the standard Ontario Owner's Policy, which is arranged by the lessee on a leased vehicle, is issued to the lessor as well as the lessee. If such an argument was accepted, then the lessee's insurance would not reduce the lessor's liability and the lessor's insurer would still be obliged to pay up to $1 million dollars. Of course, if the owner's excess insurance provides coverage to the lessee or operator, then the limitations on the owner's vicarious liability will be irrelevant to the owner's insurer. ■

EXPECT THE BEST

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

2 Queen St. East, Suite 1500
Toronto, Canada M5C 3G5
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com

RMC Risk Management Counsel of Canada

Blaney McMurtry is a member of the *Risk Management Counsel of Canada*, a Canada-wide association of independent law firms with expertise in meeting the needs of the risk management industry by providing a range of services for the insurance industry, risk retention groups and self-insureds.

To learn more about *Risk Management Counsel of Canada* and how its members can assist you, contact Tim Alexander (416.593.3900) or Larry Reimer (416.593.3997).

Insurance Observer is a publication of the Insurance Law Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.
Editor: Giovanna Asaro (416.593.3902)
Assistant Editor: Caroline Mostyn (416.593.3960)

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.