Vicarious Liability in the Context of Leased and Rented Automobiles

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Introduction

On March 1, 2006 the amendments to the *Insurance Act* ("IA"), the *Highway Traffic Act* ("HTA") and the *Compulsory Automobile Insurance Act* ("CAIA"), which reformed the rules for vicarious liability with respect to leased and rented automobiles, came into force. Unfortunately, this caught the insurance industry a little off-guard. For these amendments to have their desired effects a number of automobile policy and endorsement wordings required amendment and some new endorsements needed to be issued. None of this was in place on March 1, 2006. In fact, it took two sets of changes which were announced in the Falls of 2006 and 2007 to complete the reforms. In fact, it was not until January 1, 2009 that the new scheme was operating as intended.[i] There are still a number of outstanding actions which deal with accidents that occurred between March 1, 2006 and December 31, 2008. However, to simplify the issues presented in this paper it is assumed that all accidents occurred on or after January 1, 2009.

To provide some context, the next section of this paper will outline the vicarious liability regime that was in place prior to March 1, 2006. I will then outline the changes that Bill 18 made to the vicarious liability regime. I will then discuss how vicarious liability risks were and are now insured. Finally, I will make some comments regarding practice issues.

Vicarious Liability Before March 1, 2006

At common law the owner of an automobile was not liable for the negligent operation of an automobile by someone the owner had entrusted the vehicle to.[ii] Decades ago this rule was legislatively changed through an amendment to the HTA. That rule was carried forward in what is now section 192 of the HTA. That provision made both the driver and the owner liable to any person who suffered loss or damage due to the driver's negligent operation of the vehicle.[iii] The owner's liability did not depend on any negligence of the owner. The liability was simply

imposed on the owner by statute. This liability is commonly referred to the "vicarious" liability of the owner.

Section 192 also provided that if a lessee consented to the operation or possession of the motor vehicle by some other person, then that other person would be deemed to be in possession of the vehicle with the consent of the owner.[iv]

Up until March 1, 2006, no vicarious liability was imposed on either the lessee or renter of a motor vehicle. If an individual lent a leased vehicle to their spouse, the lessee was not vicariously liable for the negligent operation of the leased vehicle. The spouse would be liable both at common law and under section 192 of the HTA and the leasing company would be vicariously liable for the spouse's negligence under section 192 of the HTA. To succeed against the lessee, however, the plaintiff would need to demonstrate negligence; for example, by proving that the lessee lent the car to the spouse when he or she knew that the spouse was intoxicated.

As the lessee or renter of a vehicle had no vicarious liability the standard motor vehicle accident report in this province did not have, and still does not have, any place to gather information regarding who rented or leased a vehicle involved in a collision. This now presents problems for both the plaintiff and defence bars given that vicarious liability is now imposed on lessees.

Prior to March 1, 2006 both the plaintiff and defence bars rarely had any reason to care who rented or leased a vehicle involved in a collision. Generally, one sued persons who were known or suspected to have been negligent such as the drivers of the involved vehicles, a road authority or a drinking establishment. Additionally, one sued those who were known to be vicariously liable for the actions of the negligent entities. In most cases, this was limited to the owners of the involved motor vehicles and employers of the driver.

The New Regime

SOME BACKGROUND

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 been drinking with in a bar. Unfortunately, the young man who drove was drunk. He lost control of his leased car while attempting to negotiate a curve on a dark country road. His car careened off the road and rolled over as it passed through the ditch beside the road. The young woman, who was probably not wearing a seatbelt, was ejected from the car and sustained devastating injuries.

The young woman sued the young man driving the car 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 on in the litigation. Our firm was retained to represent the leasing company shortly before trial and we settled the claim in the Fall of 2004 for just under $10 million plus costs.[v] This settlement received significant exposure in the press. It was reported that it was the largest motor vehicle settlement ever paid in Canada.

Shortly after this settlement was announced meetings were arranged between representatives of the leasing and car rental industries and the Ontario Government. The purpose of those meetings was to convince the government to change the vicarious liability rules for leasing and car rental companies.

What the industry hoped would happen was that vicarious liability for leasing and rental companies would be abolished. This result had been achieved in the U.S. through the intervention of the federal government. The leasing industry argued that a lease was simply one of a number of methods of financing the acquisition of a vehicle. It contended that leasing companies should not be exposed to unlimited liability simply because a 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, as mentioned previously, for this new regime to take full effect the Financial Services Commission of Ontario ("FSCO") would need to make significant revisions to a number of motor vehicle liability policies and endorsements. In this paper I am going to skip any discussion of the transition problems from March 1, 2006 until December 31, 2008. By January 1st, 2009 all of the forms necessary to give full effect to the legislative intent underlying Bill were in place.

As we will see shortly, for the legislation to work as intended certain forms of policies and endorsements must be utilized by insurers of leasing and car rental companies. Do not assume that all insurers are using the proper forms even now. Some insurers have not revised their underwriting practises and continue to provide excess coverage to leasing and car rental companies pursuant to manuscript endorsements and old forms of policies and endorsements. You need to make sure all the policies and endorsements are actually produced and reviewed.

THE LEGISLATIVE CHANGES

This section is intended to give an overview of how the Bill 18 changes were intended to work. As we will see, the legislation may not always work as advertised. I will address each of the problems with the legislation and forms that I have identified in the succeeding sections.

One would have thought that the government would have made a choice between two alternative models to address the industry's concerns. It could have made the lessee solely liable for the negligence of those who operated the leased vehicle and relieve the lessor of any liability. Alternatively, it could make both the lessor and lessee liable but cap the lessor's exposure. The Ontario government, however, chose a much more complex approach. The first thing it did was to impose vicarious liability on those who rented or leased vehicles. This liability was joint and several. This change applies to both bodily injury[vi] and property damage claims.

The balance of the reforms applies to bodily injury claims only. The first reform involved capping the lessor's liability at $1 million in most cases. If the renter and/or driver have their own insurance, this capped amount can be reduced down to zero. Incidentally, the lessor's

liability had been capped in a number of U.S. jurisdictions before the federal legislation abolishing vicarious liability for car rental and leasing companies was passed in 2005. In addition, the Ontario reforms altered the priority of insurance policies making the leasing or rental company's policy excess to any insurance available to the lessee or driver. Again, this reform only applies to bodily injury claims.[vii] In respect of property damage claims the lessor's policy continues to provide the primary coverage.[viii]

The Ontario government chose to make this new regime applicable to both long term leases and short term rentals. The U.S. reforms also apply to both short and long term rentals. Given that these reforms apply to both situations, for ease of reference, I will refer to both leasing and rental companies as lessors and to persons who lease or rent cars as lessees, unless the context requires otherwise.[ix]

As previously mentioned, this scheme is contained in a series of amendments to the CAIA, the HTA and the IA all of which were contained in Bill 18.[x]

The basic scheme of the new regime is fairly easy to understand.

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).[xi] 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. This lessee liability is new in Ontario. 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 whether contractual terms can alter the liability *inter* se. The above referred to provisions apply to all types of damages (i.e., bodily injury and property) that might be caused by the operator of a leased or rented automobile.

The details of the limited liability scheme are set forth in the amendments to the IA.[xii] The provisions which limit the liability of lessors apply only to bodily injury claims. Lessors are still fully liable for property damage claims. The liability of lessors is essentially limited to $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 lessor's policy responds third.[xiii] [xiv] This scheme does not apply to motor vehicles that are used as taxicabs, livery vehicles[xv] or limousines for hire. The $1 million maximum liability of the lessor can be modified by regulation (there are currently no such regulations) or by a provision in another act or regulation obliging that vehicle to carry higher minimum limits of liability (for example, the liability of the lessor of a public bus which carries 13 or more passengers would be $8 million as required by the *Public Vehicles Act*). These amendments only apply to the vicarious liability of the lessor under the HTA. If the lessor was itself negligent, then these provisions do not reduce the lessor's liability for such negligence.[xvi]

I would remind you that if you are dealing with a property damage claim these provisions are inapplicable.[xvii] Accordingly, if a rental vehicle takes out a bridge, the rental company's

insurer is obliged to respond to such a claim as the primary insurer. Any insurance that the renter or driver has would be excess.[xviii]

After March 1, 2006 the following would be a typical 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 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 the John Lessee policy. That payment will reduce Leaseco's exposure to zero. 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.[xix]

This is how the legislation is supposed to work. However, as will be seen below, the insurers of Leaseco may discover that the regime does not work as advertised unless their policies are properly endorsed.

Finally, amendments to the CAIArequire persons renting or leasing vehicles for periods in excess of 30 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 HTA change the definition of lessee as outlined above. These changes apply to any vehicle that falls within the definition of "motor vehicle" in the HTAand to street cars. "Motor vehicle" under the HTAis defined 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 CAIA applies to motor vehicles as that term is defined under the HTA 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.

The same does not appear to be true for the amendments to the IA. The provisions that deal with the liability of the lessor specifically adopt the HTAdefinition of "motor vehicle" and the provisions that deal with insurance priorities specifically limit their application to motor vehicles as that term is defined in the HTA. Therefore, neither of these provisions appears to apply to streetcars. The result is that the liability of lessors of streetcars (if there are any) is not capped and, in most cases, their policies will be primary.

It is also clear that these provisions do not apply to any vehicle that does not fall within the definition of "motor vehicle" in the HTA. This would include leased snowmobiles, leased farm tractors, road-building machinery etc.

As previously indicated the liability caps and re-ordering of insurance policy priorities for bodily injury claims do not apply to taxicabs, livery vehicles or limousines for hire. The term livery vehicle has been defined in the regulations.[xx]

The Insurance Issues

Although this paper focusses on accidents which occurred on or after January 1, 2009, this does not imply that it will always work as anticipated by defendants and their insurers. These issues are discussed below. Additionally, I will comment on the repercussions for defendants and, in particular, their insurers if a policy is not properly endorsed.

COVERAGE FOR THE LESSEE'S LIABILITY

The standard auto policies did not provide coverage to for a lessee's vicarious liability.[xxi] Previously, it had been unnecessary to do so as "lessees" had no vicarious liability.

On October 16, 2006 FSCO issued a revised O.A.P. 1 (Standard Ontario Automobile Policy). The coverage grant (see section 3.3 of the O.A.P. 1) now makes specific reference to leasing and renting. Section 3.3.5 of the O.A.P. 1 purports to set out the priority of those policies which must respond to claims involving rented or leased automobiles. The order is that specified in section 277(1.1) of the *Insurance Act*. Of course, the re-ordering of the priority of policies under that subsection is only supposed to apply to bodily injury claims. Section 3.3 appears to mandate this re-ordering for all claims. While it is possible for the Superintendent to approve policies that do not comply with Part VI of the *Insurance Act,* the Courts have demanded clear evidence of that intention.[xxii] In my view, no such clear intention is evident from the Bulletin approving the new O.A.P. 1. Therefore, I believe that the priorities established in subsection 277(1) rather than subsection 277(1.1) of the *Insurance Act* would apply to property damage claims. Unfortunately, it will likely take one or more court cases to confirm this.

The new O.A.P. 1 specifically covers the named insured and his or her spouse for their vicarious liability arising out of the rental of certain vehicles for periods of not more than 30 days.[xxiii] However, no such coverage is extended to other insureds such as a child who rents a vehicle and lends it to someone else. Additionally, several commentators have suggested that the person who was actually driving obtains no coverage under the revised O.A.P. 1. If this suggestion is correct, for example if a named insured rents a vehicle and lends it to their child, then the named insured only would have coverage for their liability as the lessee of the vehicle. However, the child would not have any coverage under his parents' policy. This would mean that the child would have to pay for her or her own defence of the claim. Additionally, there would be a question whether the parent's insurer could subrogate against the child or the child's insurer, if any. Whether this suggestion is correct is a complex question.[xxiv]

It should be noted that the maximum weight of a vehicle covered by this change is 4500 kg. Accordingly, this change alone is not sufficient to deal with situations where a commercial insured intends to rent heavy vehicles and wants coverage for its vicarious liability as the renter. It appears that the new O.P.C.F. 27 can be modified to provide coverage for heavy vehicles.[xxv] It is important for a company renting heavy commercial vehicles to ensure that it has both appropriate primary coverage which is properly scheduled to its excess auto coverage (S.P.F. 7) to ensure that it is fully insured for its vicarious liability as the renter.

For vehicles weighing more than 4500 kg , it is also possible to provide coverage for the liability as lessee using an S.P.F. 6. However, this approach has potential problems. There is no vehicle weight limit but the vehicle cannot be licensed in the insured's name nor can the insured have assumed liability voluntarily under a contract or agreement.

On September 29, 2007, FSCO issued a new Bulletin[xxvi] which contains a new O.A.P 4 (Ontario Garage Policy) and two revised Fleet Reporting Endorsements (O.P.C.F. 21A and 12B).

The O.A.P. 4 now provides third party liability coverage to the insured in respect of its liability as a lessee for vehicles rented for periods not exceeding 30 days which are rented for the business conducted by the insured. It does not appear that there are any weight limitations under the O.A.P. 4 on such vehicles.

On the other hand the revised O.E.F. 82 (Liability for Damage to Non-Owned Automobiles and Drive, Rent or Lease Other Automobiles-Named Persons Endorsement), which is for use with the O.A.P. 4, does have weight restrictions. This amended endorsement now includes vicarious liability coverage for certain rented or leased vehicles. This endorsement is usually used to add vehicles not owned by the insured but which are owned by someone who is related to the insured. Therefore, this endorsement has the same restrictions that are contained in the O.A.P. 1.

The new O.P.C.F.s 21A and 21B (Monthly Reporting Basis Fleet and Blanket Fleet Coverage for Ontario Licensed Automobiles) provide lessee coverage. Both endorsements provide coverage for vehicles leased for more than 30 days from specified lessors and for periods not exceeding 30 days from any lessor. It would appear that the endorsement provides coverage for long term leased vehicles regardless of weight. However, short term leased vehicles cannot exceed 4500 kg in weight.

COVERAGE FOR DRIVERS OF LEASED AND RENTED VEHICLES

Background

Before discussing the O.P.C.F. 5 and O.E.F. 98B, 110 and 120 endorsements, I would like to spend a moment discussing how car leasing and rental companies handled their insurance prior to March 1, 2006.

I will start with leasing companies. The standard long term automobile lease obliges the lessee to obtain insurance on the vehicle which shows the lessor as an insured. The policy must be

endorsed with an O.P.C.F. 5 (Permission to Lease Endorsement). This latter endorsement permits the leasing of the vehicle, which the standard O.A.P 1 prohibits. Most leases require the lessee to obtain $1 million or more of third party liability coverage. Insurers of leasing programs have been aware for years that there was a risk that if they simply scheduled all of the policies of the various lessees on the leasing company's S.P.F. 7 (Standard Excess Automobile Policy) that it would not only provide insurance coverage to the leasing company but also to the driver. To avoid this result, many leasing programs provided the excess coverage pursuant to a manuscript leasing endorsement attached to the leasing company's C.G.L. or umbrella policies. This routinely provided that the endorsement afforded no coverage to anyone but the lessor.[xxvii]

Prior to Bill 18 concerns had been expressed about this approach to writing excess coverage for leasing companies. The concern was that this was really automobile insurance and, as such, should have been underwritten using a form of policy or endorsement approved by the Superintendent of Insurance.[xxviii] This concern was based on the assumption that any policy which actually provides coverage for automobile liability must be underwritten on an approved form. If a manuscript leasing endorsement does violate this requirement of the IA, then there is a real risk that the courts will conclude that the coverage should have been written on an S.P.F. 7 which would provide coverage to the driver.[xxix]

The Court of Appeal more than hinted that this concern had merit. In the *Avis v. Certas*[xxx] decision the Court of Appeal strongly suggested that these manuscript endorsements may be considered to be automobile insurance policies and coverage for drivers will be read into them.[xxxi]

There is one other underwriting issue I would like to mention at this juncture. Leasing companies also purchase S.P.F. 8 (Standard Lessor's Contingent Automobile Policy) coverage. This coverage is designed to provide coverage to the lessor if the lessee either fails to obtain any or all of the coverage required by the lease. Most leasing companies specifically schedule this coverage on their S.P.F. 7 policy. As we will see shortly, this may create double insurance where a vehicle is insured for an inadequate (but for some) amount by the lessee.

I next want to outline how a drafting problem with the legislation has apparently been "fixed" in several of the new endorsements.

The actual method utilized by the legislation to cap the lessor's liability at $1 million or less is to reduce the lessor's *prima facie* liability of $1 million by subtracting from that amount any amounts available under any other policy that insures the vehicle other than policies issued to the *lessor* (emphasis added).[xxxii] Of course, in the typical lease situation the policy is issued to the lessee and the lessor. Since the lessee's policy is also issued to the lessor, the limits under that policy probably cannot be subtracted from the lessor's $1 million exposure under section 267.12.[xxxiii] When this was pointed out to the IBC a provision was incorporated into the several of the new and revised policies and endorsements, including the revised O.P.C.F. 5 and 5C and the new O.E.F. 110 and 120 endorsements, which provides that any policies that such

endorsements are attached to are deemed not to be issued to the lessor for the purposes of section 267.12 of the *Insurance Act*. Hopefully, this change will permit the policy limits under such policies to be subtracted from the lessor's limited exposure under section 267.12 of the *Insurance Act*. The result will be that for leased vehicles, the existence of $1 million of coverage contracted for by the lessee will be sufficient to discharge all of the lessor's vicarious liability under the legislation.

Car Rental Companies

It is now contemplated that car rental companies (i.e., those renting vehicles for not more than 30 days) will likely have in place an O.A.P. 1 with limits of $1 million endorsed with an O.P.C.F. 5C. Their excess coverage will be provided by an S.P.F. 7 endorsed with an O.E.F. 110 endorsement.[xxxiv]

I will start by discussing the O.P.C.F. 5C.

The O.P.C.F. 5C or "Permission to Lease Endorsement" applies to short term (30 days or less) rentals. It purports to provide coverage for the lessee and the driver which coverage is reduced by the amount of insurance available to the driver and lessee from their own policies. It is awkwardly worded and difficult to interpret. It accomplishes its goals, in part, by creating sub-limits of coverage. Although this was not intended, some will conclude that this implies that the policy has multiple independent limits of coverage available to each of the lessor, lessee and the driver. I have little doubt that some ingenious lawyer will attempt to convince the court to "stack" those limits as was done with the old S.E.F. 42.

There is also an argument that by reducing limits to the driver and the lessee, this endorsement contravenes the minimum liability provisions set forth in section 252 of the IA. I do not think that such an argument is correct, but if it is applied by the courts it could increase the coverage under a rental company's policy modestly.

The O.P.C.F. 5C also purports to re-order the priority of insurance policies, not just for bodily injury claims but also for property damage claims. It is unclear whether this was intended or not. As was discussed with respect to the O.A.P. 1, it is unclear whether the priorities established by the policy wording or those established by section 277(1) of the IA will take precedence.[xxxv] For the reasons previously expressed in respect of the O.A.P. 1, it is my view that for property damage claims the lessor's insurance is primary notwithstanding the provisions of the O.P.C.F. 5C. In any event, this discrepancy will almost certainly lead to litigation.

Before discussing the O.E.F. 110, I want to recap where we are with car rental companies. If they obtain their primary coverage through an O.A.P. 1 with limits of $1 million endorsed with an O.P.C.F. 5C, then that policy alone should be sufficient to discharge their vicarious liability obligations under section 267.12 of the *Insurance Act*. It may not be sufficient to discharge their obligations for property damage claims or if the car rental company itself has been negligent. If the driver or renter has their own insurance, then the rental company's vicarious liability

exposure will be reduced from $1 million to whatever sum, if any, is left after subtracting the total amount of insurance available to the driver a