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Technical Advisory

Revised 9/11/2008

TA 266

August 13, 2008

Saving money on expenses has always been something of a national pastime. These days, it often borders on an obsession. Often, prudent measures taken to make responsible purchasing decisions pay off. However, many efforts to cut costs could only be described as “penny wise and pound foolish.”

Nowhere is this more true than in insurance. Most insurance agents “could write a book” about some of the choices consumers often make about their insurance protection. A prime example is the small commercial insured that has his company purchase an auto, which he then leases to himself (for a nominal fee).

The trend in auto leasing has skyrocketed in recent years. Some industry reports show that about half of all luxury autos are leased, while around twenty percent of autos in general are leased. In addition to getting a “new” vehicle every couple of years, leasing does provide some financial and tax savings for companies.

Under traditional circumstances, a company (Smithco) leases an auto from a new car dealer. Smithco adds the leased auto to their Business Auto policy, and the lessor (Ford Credit, for example), is shown as an Additional Insured Lessor in the Business Auto policy of the Smithco (the lessee).

On the other hand, in an effort to save even more money, Jack Smith (owner of Smithco) might have Smithco purchase the auto, then lease it to himself. In addition to the normal financial benefits of leasing, Jack also seeks to save even more money by adding the leased auto to his Personal Auto policy, adding Smithco as an Additional Insured Lessor, and avoid Smithco from having to insure the auto. In fact, in many cases such as this, Smithco will not have a Business Auto policy at all, and will only have Hired and Nonowned Auto coverage under a CGL or BOP.

Does this arrangement provide even more financial savings for Smithco, or is it a recipe for disaster? The answer lies in the coverage provided to Smithco as Additional Insured Lessor under Jack's Personal Auto policy. In the following discussion, Smithco is the lessor, and Jack Smith is the lessee. Here is the pertinent excerpt from the Additional Insured – Lessor (PP 03 19):

1. We will pay damages for which the lessor becomes legally responsible only if the damages arise out of acts or omissions of:

(a) you or any "family member", or

(b) any other person except the lessor or any employee or agent of the lessor using "your leased auto

Two problems exist for Smithco as lessor. First, Smithco is covered only to the extent that they are made liable by someone else (See above: *We will pay damages for which the lessor becomes legally responsible only if the damages arise out of acts or omissions of...* [others as described in (a) or (b)]. [Emphasis added.]

The gap for Smithco is any potential liability they incur due to their own actions, rather than the vicarious liability from others.

For example, following an at-fault accident with the leased auto, a plaintiff might allege that Smithco failed to properly maintain the brakes, tire inflation, or other maintenance responsibilities as owner. In fact, with a small, closely held company such as Smithco, it's quite likely that all the maintenance expenses are paid by Smithco, and not Jack. In this case, Smithco could plausibly be sued for failure to properly maintain the car in a safe condition, and thus their legal liability is not vicarious but direct. Smithco would not be covered by the lessor endorsement under Jack's PAP for its own negligence.

In addition, if Jack has a bad driving record, it is possible that Smithco might also be sued for failing to use due diligence in letting someone with several drunk driving convictions drive its vehicle. While Smithco might argue that they were made liable by someone else (Jack, the driver), plaintiffs sometimes are successful in alleging that a separate tort was committed by Smithco itself (vs. vicariously) for allowing unsafe drivers to operate its cars. Under the lessor endorsement in Jack's PAP, Smithco has no coverage for its own negligence.

In a traditional lease (where Smithco had leased an auto from Ford Credit), the lessor is at arm's length from the lessee in terms of being responsible for determining the driving record of the lessee's operators. However, the insulation Ford Credit enjoys from the arm's length transaction might not be true where Smithco leases the car to Jack Smith, and is found liable for its own failure to screen and restrict permissive drivers.

The second problem for Smithco in the lessor's endorsement under Jack's PAP is the coverage gap that Smithco has in the limitation as to the source of their vicarious liability, as found in 1. (b):

1. We will pay damages for which the lessor becomes legally responsible only if the damages arise out of acts or omissions of:

(b) "any other person except the lessor or any employee or agent of the lessor using "your leased auto." [Emphasis added.]

In other words, if Jack lets one of Smithco's employees drive the leased auto, and the employee has an at-fault accident, Smithco is not covered under the lessor endorsement in Jack's PAP, since the driver is an employee of the lessor (Smithco).

In a misguided attempt to save money, Smithco likely has only Hired and Nonowned Auto coverage under a BOP, CGL, or BAP with symbols 8 & 9 only. This won't help Smithco here, since they *own* the auto.

Another potential problem Smithco might face is a limits gap with their other commercial insurance, especially their umbrella. As discussed above, Smithco is relying solely on Jack's PAP for their exposures related to the auto they lease to Jack.

Another gap would arise if Smithco decided to purchase another auto. Since they elected to only have Hired and Nonowned Auto coverage, they would have no coverage for an owned auto. In addition, the "newly acquired" coverage in Jack's PAP would not protect Smithco, as it only applies to autos newly acquired by "you" – which is the Named Insured and resident spouse.

Probably the most prudent approach for Smithco is to retain coverage for the auto under their BAP, with Symbol 1 for liability and Symbol 2 for physical damage.

While leasing a company car to yourself might make financial sense, in some situations, it can create serious insurance gaps.

Reader Response

Subject: Alternatives to Leasing a Company Car to Yourself

Q. We have been discussing your recent article – "Leasing A Company Car To Yourself."

Here is an alternative we recommend to our insureds. We find it saves them some premium, and it provides coverage for both the business and the individual.

Let's say the business is Smithco, Inc., which is principally owned by Jack and Jill Smith (to continue the example from the Technical Advisory). We currently write a Personal Auto Policy for Jack and Jill, and a Business Auto Policy for Smithco. Jack drives a Cadillac Escalade, and Jill drives a Lincoln. Smithco owns one auto – a Taurus provided to the sales manager – and their BAP has symbols 7, 8 & 9.

Jack decides to trade the Escalade for a Lexus. He considers having Smithco purchase the Lexus, which he would lease to himself and insure under his PAP – as discussed in the Technical Advisory. However, he elects not to mess with a lease. He has Smithco purchase the Lexus (titled to Smithco) for his use, which he adds to his PAP, with Smithco added as an Additional Insured.

We think both Jack and Smithco are now covered, without the gaps that are present in the Additional Insured Lessor endorsement you discussed in the Technical Advisory.

Do you think this approach solves the problem? We are attaching a copy of the PAP insurer's Additional Insured endorsement for your review.

A. In my view, comparing this arrangement with the leasing situation discussed in the Technical Advisory, Jack and Smithco have done little more than swap deck chairs on the Titanic, as the saying goes. Here are my concerns.

Smithco owns an auto but does not insure it (since they have only symbols 7, 8 & 9). I feel this particularly risky and unwise. Smithco is depending solely on Jack's PAP, and if there are any gaps in coverage or limits, Smithco could take it on the chin financially, having no coverage in their name.

I reviewed the Additional Insured endorsement you sent. Actually, it provides essentially the same coverage that is automatically included in a standard ISO Personal Auto Policy. That is why ISO does not have an Additional Insured endorsement for the Personal Auto program – the coverage is already built into the language of the PAP. Here is the relevant excerpt from Jack's PAP:

Part A – Liability

B. "Insured" as used in this Part means:

3. For "your covered auto," any person or organization but only with respect to legal responsibility for acts or omissions of a person for whom coverage is afforded under this Part. [Emphasis added.]

So what coverage does this provide Smithco, and what potential gaps do they have? First and foremost, it is important to note that the only coverage provided Smithco is vicarious liability. That is, if Jack has an at-fault accident, and the injured party sues both Jack (as driver) and Smithco (as owner), Smithco is covered under Jack's PAP because they were made liable by "a person for

whom coverage is afforded under this Part.” In other words, since Smithco was made liable by Jack, Smithco is an insured in this particular accident.

On the other hand, if the sole or a contributing factor in the accident was a maintenance deficiency such as under-inflated tires, bad brakes, etc., Smithco's liability here is most likely not vicarious, but direct, if the maintenance and repair bills are paid by Smithco.

Secondly, there is no coverage for a newly acquired auto, should Smithco purchase another vehicle. In Smithco's BAP, symbol 7 applies to newly acquired autos *“only if we already cover all autos you own for that coverage or it replaces an auto you previously owned that had that coverage.”* Since Smithco's BAP does not cover the Lexus they bought for Jack, they lose the automatic coverage for newly acquired autos.

And while Jack's PAP provides automatic coverage for newly acquired autos, it only applies to autos acquired by “you” – which is defined as the named insured and resident spouse.

Also, there is a potential gap for any physical damage claims. Jack's insurer might well deny a claim under Part D, since the auto is not owned by Jack or Jill, thus they have no insurable interest in the vehicle. This is of course one of the reasons many small business owners lease the car to themselves (as discussed in the Technical Advisory). This creates an insurable interest for the lessor (Smithco in this case) under the Additional Insured Lessor in the PAP. Recall, however, the coverage gaps that exist for Smithco through the Lessor endorsement, which were discussed in the Technical Advisory.

Another issue for Smithco is the potential limits gap between their BAP and Jack's PAP. Also, if Smithco has a commercial umbrella, there might be a coverage gap for the Lexus which is covered only under Jack's PAP. And if Jack has a personal umbrella, it may or may not cover Smithco.

More broadly, it is important to know if Jack's insurer knows of and agrees to adding a corporately-titled vehicle to the PAP. Under ISO rules, such a vehicle is not eligible for a PAP. Therefore, it is not beyond the realm of possibility for an insurer to deny any and all claims arising out of a non-owned auto added to the policy, due to an allegation of fraud or misrepresentation – especially if the agent knew about the ownership and added the car anyway. On the other hand, some insurers permit this arrangement. However, in my view, even if the insurer will knowingly add a corporately-titled auto to the PAP, this does not guarantee that the vehicle owner (Smithco) won't have any coverage gaps, such as those discussed here.

Lastly, there is always an E&O concern in dealing with coverage issues which involve not only two separate entities, but also two significantly different types of

policies such as BAP and PAP. And in cases where the agent “recommends” one approach over the other (as in your question), care should be taken to discuss coverages and options with the insured, and also maintain proper E&O documentation.

For more information on this important and complex issue, you will find an excellent article on the Virtual University of the Independent Insurance Agents & Brokers of America (IIABA). Go to: <http://www.iiaba.net/vu> .

Access to the VU is free to all member agencies, but an ID and password are required. First time visitors to the VU need only click the “Subscribe Today” link, provide the necessary information, and an ID/password will be emailed.

Once on the VU, select Research Library. In the Insurance Library, you will find the following article in both the Commercial Auto and Personal Auto sections:
“Insuring Business-Owned Autos Under a PAP.”