New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
Web address: http://www.nylj.com
VOLUME 234—NO. 36 MONDAY, AUGUST 22, 2005 ALM

OUTSIDE COUNSEL

BY J. JAY YOUNG AND COREY A. TAVEL

Vicarious Liability of Rental Firms Preempted by Federal Law

On Aug. 10, 2005, accident victims injured due to the negligence of a rental or leased vehicle operator lost a major avenue of recovery with the passage of H.R. 3—The Transportation Equity Act. The new federal law is ostensibly a transportation enactment, providing tremendous funding for substantial highway improvements throughout the 50 states.

However, an amendment to the bill, introduced by Representative Sam Graves, R-Mo., has eliminated vicarious liability, as it applies to rental car and leasing companies.

Prior to this new law, very few jurisdictions recognized vicarious liability. Of those that did, most placed monetary limitations. New York, however, posed the greatest threat to the rental and leasing industries, since it was a state where the impact of vicarious liability was most significant. For years, these industries had been lobbying the New York Legislature to amend §388 of the Vehicle and Traffic Law (VTL)—without success. Needless to say, Congressman Graves, a representative of a nonvicarious liability state, is now being hailed as the savior.

Effective the day it was signed by President Bush and applied to lawsuits filed on or after that date, New York and the other affected states including the District of Columbia, now join the rest of the country regarding vicarious liability. New York's §388 of the VTL no longer applies to leasing or rental companies and these entities will no longer be held liable, via mere ownership, for the negligent acts of their permissive users.

While this new statute is a significant win for the rental and leasing industries, rental companies must beware, as there will still be exposure for accidents involving their vehicles. Truth be told, their exposures include:

J. Jay Young *Corey A. Tavel*

Section 388 of the Vehicle and Traffic Law no longer applies to leasing or rental companies and they will not be liable, via mere ownership, for the negligent acts of their permissive users.

insurance that must be provided for the vehicle operator as well as negligent entrustment, products liability and negligent maintenance, and employee use.

Experience across the nation shows that where there is no vicarious liability law, there are clearly other avenues of common-law liability and litigants travel those paths. In fact, they do so more frequently, with more fervor and more persistently when the injuries are significant or catastrophic. In those jurisdictions where the plaintiff trial bar has now lost a deep pocket, it is safe to assume, in the more serious accident cases, that they will seek to create liability on the corporate defendant, as has been seen in the rest of the country for many decades.

Mandatory Insurance

Insurance Law (IL) §3420 mandates that every vehicle in New York is to maintain the minimum Financial Responsibility Limits (FRL). Rental companies must provide the FRL for any authorized operator of the rental vehicle. Currently, those limits are $25,000 per person and $50,000 per accident for bodily injury. The company must also provide $10,000 for property damage. In the case of a death, there are additional limits of $50,000 for each death, subject to a limit of $100,000 for all deaths. Rental car companies in New York must maintain the FRL as primary to all other insurance. Despite the elimination of vicarious liability, the rental company still has exposure up to the FRL as well as associated legal expenses.

The exposure present by the FRL can be significant. In an accident, where two potential claimants are seriously injured and two are killed, along with extensive property damage, the total exposure under the FRL limits is $160,000 ($50,000 for the two injuries, $100,000 for the two deaths, and $10,000 for the property damage). While not full vicarious liability, this exposure cannot be ignored.

The liability is even greater if we factor in other mandatory coverages required under New York's FRL. IL §5102 requires a vehicle to maintain $50,000 in no-fault benefits per person injured in the vehicle. If a vehicle had five passengers, the no-fault exposure alone is $250,000. In addition, under certain circumstances, pursuant to IL §5105, the insurance company for the other vehicles involved in the accident may seek reimbursement against a tortfeasor's insurance/self-insurance of the no-fault benefits they paid out. This type of reimbursement does not reduce the bodily injury/property damage policy limits. If the rental and adverse vehicles each had five occupants, if the accident was the fault of the rental driver and it qualified for reimbursement, the no-fault exposure

J. Jay Young *is CEO of Smith Mazure Director Wilkins Young & Yagerman and member of the firm's executive committee.* **Corey A. Tavel** *is managing attorney and also a member of the executive committee.*

would be one-half million dollars.

In addition to the no-fault and liability limits, each vehicle must also maintain uninsured motorist coverage of $25,000 per person and $50,000 per accident for bodily injury.

Despite the elimination of vicarious liability, there are significant insurance-related exposures under state salutatory minimum financial responsibility laws.

New York rental companies will now join the rest of the country subject to liability based upon negligent entrustment. Throughout the country, in nonvicarious liability states, to attach common-law liability upon an automobile rental company, the well-established rule that an owner who entrusts a motor vehicle to an incompetent driver is responsible for damage or injury resulting there from, has been extensively relied upon.

In essence, this theory of liability permits a third-party to recover damages from a party who "entrusted" goods within his control to a user if the user injures the third party through inexperience, youth, incompetence or otherwise, in handling the goods and the "entruster" knew or should have known of the user's inexperience, incompetence, youth or otherwise. In short, a rental company may be charged with knowing or having reason to have known that a renter's use of the rental vehicle was going to pose an unreasonable risk of physical harm to other persons who the rental company should expect to be engendered by the renter's use.

While negligent entrustment theories began with the entrustment of statutorily restricted goods, it has found increasing and widespread judicial acceptance across the many states which have not had ownership-based vicarious liability, and in response to the creativity of personal injury attorneys looking for a deep-pocket defendant.

Under the theory of negligent entrustment, the rental company's liability for the negligence of the driver/renter does not arise out of mere ownership but, instead, arises from the rental company's provision of the vehicle initially. This well-established doctrine of law places liability upon the rental company, not for its mere ownership, but for its own specific actions, similar to a claim of negligent hiring or training of employees. Negligent entrustment is a common-law-based doctrine of responsibility and it is expected that such claims will proliferate in New York where vicarious liability of owners has been the public policy and which policy has now been preempted by federal law as to rental and leasing companies.

In short, the theory of negligent entrustment, as it relates to automobile rental companies, has been an accepted theory throughout the country and it will now sprout in the states where ownership-based vicarious liability previously existed.

While the specific elements of the doctrine must be met for a claimant to survive a summary judgment motion by the defendants and to succeed at trial, the mere cost of defense of a negligent-entrustment-based suit is likely to be of great significance. These claims should not be taken lightly nor viewed as nuisance suits. In all likelihood, the suits will be expensive to defend, involve significant or multiple injuries and, if recovery is had, the indemnity portion of the claim will be of even greater significance.

Failure to Maintain

This area of exposure applies to rental companies and rarely, if at all, to leasing companies. In serious accident cases, such as those involving rollovers, crushed roofs, failure of air bags and seat belts, the rental company should expect to become party to a products liability lawsuit. While the manufacturer will, in all likelihood, be named in the case, the cost of defense alone in these types of cases is, quite often, into the six figures. In addition, these claims often involve one-vehicle accidents in which family members or friends are injured, if not catastrophically, then very seriously. The cases are often "friendly lawsuits," where the operator supplies fodder for an expert retained by plaintiff's counsel. Upon that helpful information, the attorney seeks to press the court to find an issue of fact, which requires jury determination. Once the case becomes a jury question, the exposure is clear and present to the rental company.

The elimination of vicarious liability for rental and leasing companies will reduce their financial exposure. Rental companies will no longer be considered the deep-pocket target of litigation.

More of an exposure, from an indemnity standpoint as opposed to a cost of defense point of view (as in the products liability claim), is the failure to properly maintain one's vehicle. Again, these lawsuits usually involve "friendly" operators, renters or occupants as well as multiple and significant-to-catastrophic injuries. Testimony as to poor brake performance, ineffective windshield wipers, wheel alignment defects, among other things, make for expert testimony sufficient to get a case to a jury trial rather than a dismissal by the court as a matter of law.

The products field also brings spoliation of evidence issues into play in these serious injury accidents. Failure to properly maintain the post-accident status of the vehicle in question, in certain circumstances, can create liability upon a rental car company for spoiling the evidence upon which claimants had intended to base their products liability suit.

This would expose the rental company to liability for indemnity in addition to the enormous defense cost of a products liability suit.

Employee Accidents

In addition to the more-tenuous, more-difficult liability doctrines discussed above, most of which will involve serious injuries and larger exposures, there still, of course, remains liability of the rental company for the negligent acts of its employees in the course of their employment. This liability stems from common-law employer/agency responsibility and is unaffected by the new law signed by the president.

Conclusion

Without a doubt, the elimination of vicarious liability for rental companies and leasing companies will significantly reduce their financial exposure. Rental companies, barring negligent entrustment, failure to maintain, defective product or employee liability, will no longer be considered the deep-pocket target of litigation. Cases will most likely settle earlier when the plaintiff's bar understands they are limited to the FRL, thereby reducing legal fees. The rental company and their counsel, however, must be aware of the potential exposures. A statutory increase in FRL as to rental and leasing companies in New York would be a natural response to the federal preemption of their longstanding public policy in favor of ownership-based vicarious liability. Whether these entities can be singled out for increased FRL remains to be seen. In addition, it would not be surprising to see a state legislative backlash, resulting in higher FRLs in general.