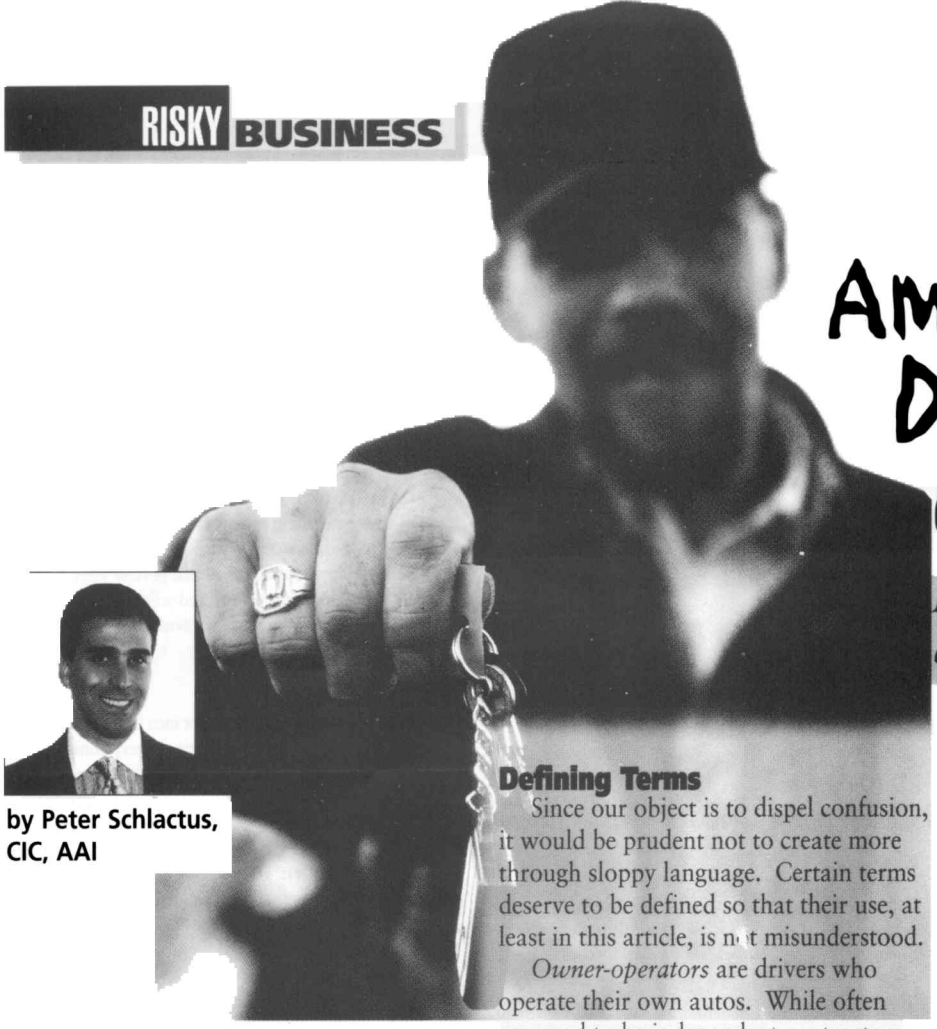
Am I My Drivers' Keeper?

Answers to Questions about Driver-Owned Autos



by Peter Schlactus, CIC, AAI

Use of motor vehicles creates huge risks for delivery companies. Autos and trucks can — and do — cause grave injury to persons and destruction of property.

For companies that own or lease their fleet, issues of liability and insurance are straightforward and generally well understood. Managers can minimize risk, set priorities and respond to accidents knowing the rules of the game. Unfortunately, where companies use driver-owned vehicles, any semblance of consensus disappears. Conflicting assumptions about responsibility, law and the cost and availability of insurance create confusion that inhibits wise decision-making ... sometimes with tragic consequences.

Who *is* liable for accidents? Are owner-operators, employees or independent contractors ... and does this matter? Is it necessary for you to insure these vehicles and, if so, how? More than one delivery service that misunderstood these issues has been decimated because it failed to properly protect itself.

Defining Terms

Since our object is to dispel confusion, it would be prudent not to create more through sloppy language. Certain terms deserve to be defined so that their use, at least in this article, is not misunderstood.

Owner-operators are drivers who operate their own autos. While often assumed to be independent contractors, many owner-operators are treated and paid as employees. Their autos may be owned outright or leased, but the drivers are responsible for their vehicles and maintain their own insurance.

Drivers who operate their own vehicles are *not* contractors by virtue of that fact. Issues of control, work and pay determine status. But unless drivers are owner-operators, they cannot be considered contractors. Those who drive your company fleet vehicles must be considered employees (excepting, perhaps, for certain lease-back arrangements).

Driver-owned vehicles will refer to the autos of owner-operators. From your perspective, one could call them *non-owned autos* or *hired autos*, but these terms are less specific — they could, for example, apply to rental vehicles — and they also invite confusion with similar technical terms found in auto insurance policies.

Whose Responsibility?

Understandably, business owners would prefer to disavow all responsibility for accidents involving owner-operators and driver-owned vehicles. "They're not my vehicles, so they're not my problem," say some. "I'm not legally responsible for ICs," insist others. "That's why the driver has insurance."

Various laws and legal precedents of different states make it difficult to write of absolutes, but the general rule that emerges from years of observation is undeniable: *delivery services can and usually will be found liable for accidents involving driver-owned vehicles*. Small comfort can be taken from the fact that your liability is normally secondary to that of the driver.

There are four principal ways companies are found liable. First, a company is liable for the acts of its employees. Where owner-operators are treated as employees, you must expect to be held liable for their work-related accidents. Moreover, the status of contractors is always open to challenge. A plaintiff may argue that the driver who injured her was a *de facto* employee of your company.

Second, the laws of agency come into play. An "agency relationship" is created between two parties where one has the express or implied authority to act on behalf of the other. Authorized acts of the agent are considered to be acts of the principal who is entitled to the benefits (i.e. you, the company owner). It is not difficult to make the case for agency where an independent contractor (IC) is responsible for carrying out your company's deliveries (from which you derive profit), has the authority to determine delivery methods and routes, and appears to customers as your representative. You, the principal, are liable for the wrongful acts of your agents.

This issue of agency is a prime reason that many of your customers and business partners want evidence of insurance from you and why they demand to be an additional insured party on your insurance policies. They and their legal counsel fear being held liable for the acts of your (i.e. their agents) agents.

A third concern is the charge of *negligent hiring*. Especially where the driver is cited for speeding or other infractions, you can be accused of negligence in hiring reckless drivers.

Last, companies engaged in interstate commerce — or in states that regulate common carriers — can be held liable for statutory guarantees of compensation to accident victims, regardless of other factors. To the surprise of many, so-called 'deregulation' has left largely intact rules regarding insurance requirements and public accountability of motor carriers.

At KBS, we have reviewed the preceding factors with many company owners. Some are more easily persuaded than others; but almost no one denies that — irrespective of legalities — in practice, the system is stacked against you.

Imagine yourself in court. Your attorney is addressing the jury, entreating them to release you from liability for injuries to a severely maimed mother and brain-damaged child of three (a real case).

Your defense: the driver was technically an independent contractor — paid on a 1099 form, not a W2 — and you never authorized him to make a left turn without checking traffic. The driver's insurance is limited at best, so the jury must choose between tapping into your assets or leaving the injured family to its own devices. What odds do you give yourself?

Secondary Liability — Small Comfort

While delivery services need to operate on the assumption that they could be found liable for accidents involving *driver-owned vehicles*, all liability is not created equal. Your liability does not absolve the driver from his or her own responsibility. Indeed, in almost all jurisdictions the driver's liability will be primary, meaning that the driver's insurance will have to pay damages first. Only after the driver's primary insurance runs out would your secondary insurance have to pay damages.

While this may bring some comfort to owners, we cannot recommend too hearty a celebration. First, just being named in a lawsuit can force you to incur substantial legal expenses to make sure you are properly represented ... even if your liability is determined to be secondary. Second, a driver may turn out to have *no* insurance at the time of the accident — even if you checked the policy at its last renewal — which you certainly should! Unpaid bills quickly lead to cancellation.

A third concern is that, in serious accidents — when it matters most — the driver's insurance may well prove inadequate. This is especially true if the driver carries only your state's minimum legal limits of insurance. All delivery services should either have a rule that drivers must carry higher limits (100/300/50 is recommended) or an incentive for drivers to do so.

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The Source of Protection

Almost unintentionally, the insurance industry has provided a means of protecting your business from its liability for *driver-owned vehicles*.

Every commercial auto insurance policy has on its declarations pages (face pages) a set of numerical symbols that denotes the types of vehicles covered for each type of protection, including liability insurance. You can cover listed or scheduled vehicles, all vehicles you own or only private passenger vehicles you own, etc.

The numbers *8* and *0*, which should grace *every* delivery company's insurance declarations, indicate that the policy will cover your liability for non-owned and hired vehicles. Without venturing into the esoteric details of what is meant by each term and which vehicles are covered by each category (a subject open to debate), suffice it to say that, with both numbers listed you should have no problem.

Together, these coverages are called *Non-Owned* and *Hired Auto Liability Insurance*. Note that your policy covers *your* liability, not the driver's. Just as their insurance will not eliminate all of your risks, yours does not give them reason to let their own insurance lapse.

Note also that the policy provides coverage almost unintentionally. This is because *Non-Owned* auto insurance was created to cover a business responsibility for such risks as sending an employee out to pick up mail. Likewise, *Hired Auto* coverage was intended primarily to cover vehicles a business might rent for a day or week.

These facts are worth mentioning because they play a role in the major disputes that many delivery services ultimately have with their insurance companies over policy rates and premiums.

Beware the Premium Trap

It is not unusual for delivery services to find that the premium charge for *Non-Owned* and *Hired Auto Liability Insurance* is quite nominal, especially when their policy also covers the company's own vehicles. Many owners assume that the insurance company has thrown in the extra protection as a bonus for insuring the vehicles.

Rarely is this the case, however. Underwriters — sometimes misled by unaware or unscrupulous agents — simply overlook the risks of owner-operators and focus instead on the traditional roles of *Non-Owned* and *Hired Auto* coverage as previously described. Often, these appear minor enough and minimum premiums are used.

The problem lies in the fact that the insurance is auditable. An auditable policy is not necessarily bad but, when you are unaware of the fact, it can administer a nasty financial shock. Upon audit — whether triggered by renewal or a claim — the policy rate for Hired Cars may be applied to the total compensation you pay your drivers, creating a revised premium.

While policy rates can range from $1 to $10, a conservative $2.50 rate can produce an audit charge of $12,500 for a company with 20 drivers. This is over twice what you would pay for specialized insurance where the insurance company is fully aware of your drivers. What you *don't* pay now can come back to haunt you! In fact, you can be audited for three years of policies at once. We have seen audit bills in excess of $200,000.

A few simple precautions can eliminate the problem. Insist that your agent provide *written confirmation* that the insurance company is aware of how many owner-operators you use and has charged accordingly. Preferably, this should come directly from underwriters on their stationery. Failure to comply should be taken as a strong sign that something is amiss.

Consult a delivery insurance specialist if you have any doubts. They can review your current policy for signs of risk and suggest specialized insurance programs that avoid this kind of surprise audit problem.

Summing Up

Owner-operators *do* get into horrific accidents that threaten them and their delivery companies with liabilities in the hundreds of thousands or even millions of dollars. No single delivery service experiences many of these accidents. In fact, a company can go years without a single catastrophe. But the odds of getting hit by a major claim are much greater than being struck by lightning ... and who among us does not insure our homes and offices against lightning?

Driver-owned vehicles create alarming liability risks for the delivery services that use them. On a number of grounds — including responsibility for employees, agency, negligent hiring and regulatory rules — your company can be brought into lawsuits and held liable for damages in excess of the driver's own insurance limits.

To protect yourself you need to obtain *Hired* and *Non-Owned Auto Liability Insurance*. But choose wisely. How your policy is set up and rated can determine whether or not the cure feels worse than the disease. Coverage and premium disputes are more common to these coverages than any other type of auto insurance.

Having read this article, you should be able to make up your own mind and direct your insurance brokers accordingly. If they are not as responsive or knowledgeable as you might like, you can always turn the tables and bring in a specialist to audit them! CM

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