Coverage for the Drunk Driving Employee Under the Business Auto Policy and Non-owned Automobile Endorsement

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Introduction

It is the Christmas season and the Bennett, Spence & Darrow law firm is having its annual holiday party on a Saturday night. Larry Lawyer goes to the firm's party after meeting with clients Saturday afternoon. He drinks quite a bit at the party and after the party, goes out to a bar with several fellow lawyers. After leaving the bar at 2:00 a.m., driving his own car, Larry Lawyer causes an accident, seriously injuring Plaintiff #1. Plaintiff #1 eventually files suit against Larry Lawyer and the Bennett, Spence & Darrow law firm, contending that Larry was within the scope of his employment at the time of the accident. Plaintiff #1 also contends that the law firm negligently served Larry Lawyer alcohol when he was intoxicated, knowing that he would drive after the party.

Mike Manager is the office manager for Bennett, Spence & Darrow. Mike has a company car because he often runs errands for the firm and cannot afford the wear and tear on his personal vehicle. There are no written instructions regarding Mike Manager's use of the automobile. Although the managing partner of Bennett, Spence & Darrow told Mike he is to use the car for work purposes only, he also told Mike he could run some personal errands while he was running office errands or while he was going to and from work so long as it "didn't get out of hand." Mike, however, is specifically told that he is not supposed to drink and drive while using the vehicle.

Mike Manager is upset that he cannot go to the lawyers-only holiday party, even though he organized the event. Even so, Mike goes to the banquet hall beforehand to make sure all of the arrangements are set before the lawyers arrive. Once the party starts, he leaves and goes to a bar in the company car. On his way home after several hours at the bar, Mike Manager causes an accident, seriously injuring Plaintiff #2. Plaintiff #2 eventually sues Mike Manager. Plaintiff #2's lawyer does not sue the Bennett, Spence & Darrow law firm because he does not want to cloud the case with questionable scope of employment issues. Plaintiff #2's lawyer figures that because the vehicle was owned by the law firm, there is plenty of insurance available for the claim without joining the law firm as a party.

A myriad of issues arise from the two scenarios involving Larry Lawyer and Mike Manager. The scope of employment issues, in and of themselves, can be very complex and dependent on case law from jurisdiction to jurisdiction. But what about coverage for the claims?

With regard to the suit against Bennett, Spence & Darrow arising from Larry Lawyer's accident, the firm most likely has an endorsement in its Professional Liability Policy that covers it for claims arising from accidents involving a "Non-Owned Automobile." The purpose of the Non-Owned Automobile Endorsement is simple. A Professional Liability Policy will normally have an exclusion for any liability arising from the maintenance, operation or use of an automobile. Nonetheless, the firm is concerned that many lawyers drive their personal vehicles to depositions and so forth. One of those lawyers could cause an accident while within the scope of his or her employment and the law firm could be sued as a result. Coverage for that claim would be excluded under the standard Professional Liability Policy.

The "Non-Owned Automobile Endorsement" fills that gap in coverage. Generally, it provides that the law firm will be covered for any claims arising from accidents involving a "Non-Owned Automobile" as long as the non-owned automobile is being operated within the course of the law firm's business. Although the Non-Owned Automobile Endorsement may appear straightforward, many issues arise from its application. For instance, the carrier must address whether the driving employee is even covered under the Endorsement. Issues regarding coverage for "direct" liability claims, such as host liquor liability, negligent hiring

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and negligent supervision may also arise.

The coverage issues with respect to Mike Manager's accident are distinctly different. Mike Manager was not operating a "Non-Owned Automobile" at the time of the accident. The automobile was owned by the law firm. The law firm has three vehicles and has a Business Auto Policy that covers those three vehicles. Such policies typically have an "omnibus clause," providing that the driver of the vehicle is covered only if he is using the vehicle with permission. Employees usually are forbidden from using the vehicle for personal use, with the exception of occasional errands, such as stopping at the grocery store, picking up laundry, going to the doctor, etc. In almost all cases, the employee is either verbally or in writing admonished that he/she is not supposed to drink and drive while using the vehicle.

The purpose of this paper is to provide an overview of the key issues arising out of the drunk driving employee under the Business Auto Policy and Non-Owned Automobile Endorsement. While the facts that implicate the Business Auto Policy and Non-Owned Automobile Endorsement will vary from case to case, the primary coverage issues that arise are: 1) if the employee is driving a company car, whether the employee's use of the car was with "permission;" and 2) if the employee was driving his personal automobile, whether the employee was in the course and scope of his employment at the time of the accident.

Mike Manager and Permissive Use Under the Omnibus Clause of the Business Automobile Policy

The Business Automobile Policy's insuring clause, often referred to as the "omnibus clause," most likely provides:

> **LIABILITY COVERAGE**
>
> **A. Coverage**
>
> We will pay all sums an "**insured**" legally must pay as damages because of "**bodily injury**" or "**property damage**" to which this insurance applies, caused by an "accident" and resulting from the ownership, maintenance or use of a covered "**auto**."
>
> **1. Who is an Insured**
>
> The following are "insureds:"
>
> **a.** You for any covered "auto."
>
> **b.** Anyone else while using with **your permission** a covered "auto" you own, hire or borrow except:

Given this definition of "insured," the issue is whether the employee's use of the vehicle was with "permission" such that the employee falls with the scope of the policy's omnibus clause. If the employee has permission to use the vehicle for business purposes and some limited personal use, but at the time of the accident is using the vehicle in a manner that the employer would not permit, will that use be considered "permissive use" by the courts such that the insurance carrier has to provide coverage for the accident or will the employee's "deviation" be enough to vitiate coverage?

State laws are not uniform on this issue, and have adopted three main approaches to the "deviation" issue:

1. The "liberal" rule; or
2. The "strict" or "conversion" rule; or
3. The "minor deviation" rule.[1]

Under the "liberal" rule, coverage is available under the Business Automobile Policy so long as the vehicle was originally entrusted to the person who at the time of the accident was operating the vehicle. In other words, if the employer provides the keys, the employer's insurance carrier must provide coverage for any accidents that result regardless of whether the employee used the vehicle in a prohibited manner, such as a drinking venture, at the time of the accident.

A good example of a state following the "liberal" rule is New Jersey. In *French v. Hernandez*, Hernandez was permitted to use the company truck, but only on the employer's property.[2] At the end of the work day, Hernandez took the truck on a drinking venture and caused an accident while intoxicated. The court held that, under any interpretation of the omnibus clause, Hernandez's virtual theft of the truck exceeded any permitted use and there was no coverage. The court, however, reiterated its "liberal" interpretation of the omnibus clause that "as long as the initial use of the vehicle is with the consent, express or implied, of the insured, any subsequent changes in the scope or character of the use . . . do not require the additional specific consent of the insured."[3] New Jersey believes a narrower rule would "render coverage uncertain in many cases, foster litigation as to the existence or extent of any alleged deviations, and ultimately inhibit . . . the legislative goal" of providing maximum liability coverage.[4]

A second approach is the "strict or "conversion" rule. Under this rule, the accident must be within the time and space of the permission or it is not a permitted use and there is no coverage. Few states follow the "strict" or "conversion" rule, and even in those states, the court decisions are old enough to question whether they would be deemed representative of modern law, which has a bias towards finding coverage for the protection of injured drivers. In *Gray v. Sawatzki*, the court held that any deviation from the scope of employment and express permitted use of the vehicle was enough to avoid coverage.[5] In *Johnson v. Am. Auto. Ins. Co.*, the court held that a minor deviation of taking a neighbor on an errand after the employee took a truck home to wash it was sufficient to avoid coverage when that use exceeded the employer's express permission.[6] In both cases, the courts did not look to public policy reasons or otherwise to enlarge "permission" beyond that initially granted. Again, in any permissive use case, the *Gray*

and *Johnson* decisions would appear to be of limited value. Those cases were decided in the years before judicial interventionism in insurance matters and the public policy of expanding coverage to the broadest extent possible to protect injured drivers. Even in Michigan and Maine, courts may very well reach a different result today.

If the state where Mike Manager's accident occurred follows either the "strict/conversion" rule or the "liberal" rule, the coverage issues are easy to apply. Under the "strict/conversion" rule, there is no coverage for Mike Manager's accident because he was using the vehicle in a forbidden manner. If the state applies the "liberal" rule, there is coverage for the accident because the law firm entrusted the vehicle to him in the first instance and there is coverage for any accident that results, regardless of the scope of permission.

The "minor deviation" rule is much more difficult to apply. Under the "minor deviation" rule, there is coverage so long as the use is not a material or gross deviation from the terms of the original permission.

A good example of a state that applies the "minor deviation" rule is Texas, where the primary case is *Coronado v. Employer's Nat'l Ins. Co.*[7] In *Coronado*, Sotelo was a unit operator for White Well Service and was assigned a company pickup. The company yard was located a few miles from the town where Sotelo and the other workers lived. Sotelo normally used the truck to transport workers from home to the yard and to the various wells they serviced. One day, he stopped at a bar on the way home with the other workers. They stayed at that bar for three to four hours and then went to another bar until midnight. Shortly thereafter, Soleto caused an accident that killed the occupant of another vehicle, Coronado.

After obtaining a verdict against Sotelo, Coronado's estate brought an action against Employer's National for indemnity under its policy. After considering the alternative rules, the Texas Supreme Court adopted the "minor deviation" rule and held that Sotelo had committed a material deviation from the scope of his permission.[8] Coronado's estate argued that there was implied permission by acquiescence because on two other occasions the owners of White Well Service had witnessed Sotelo drink a beer or two after work before operating the company truck. The *Coronado* court held that this was insufficient "implied permission" for him to use the truck "for an eight hour drinking spree wholly unrelated to the time, place or purpose from the objectives for which he was granted use of the vehicle."[9] Sotelo's deviation was so gross as to be a material deviation as a matter of law.

In states following the "minor deviation" rule, the courts will look at the purpose for which the vehicle was supplied, time and distance of the deviation, whether the personal use has a relationship to business purposes and any other factors relevant to a determination of whether the owner would allow the "use" at issue. Generally, late night drinking ventures are beyond such permission, even though on some occasions the employer may have previously tolerated the proverbial "couple of beers" at a bar after work, or tolerated employees driving vehicles after company functions where alcohol was served.

The "implied permission" issue is of crucial importance in states following the "minor deviation" rule. On very few occasions will there be a bright line of permission by an employer. Of course, the most important aspects of permission are written rules and/or regulations adopted by the company regarding use of the vehicle, if any. For example, the company rules and regulations may expressly preclude drinking and driving, but that may be winked at or in some situations even encouraged. An employee may routinely stop at a bar after work with the knowledge of immediate supervisors and nothing is done to reprimand that employee or stop this behavior. The employee may actually be encouraged to take customers or clients out at night for entertainment purposes and the employer knows that drinking will take place. The company may sponsor social occasions such as holiday parties where alcohol is provided.

It is therefore important that any coverage analysis take into account not just the written or "official" rules regarding vehicle use, but also the actual historical use of company vehicles, which may differ radically from the written rules. And the inquiry should not solely be directed to top management or vehicle safety supervisors. The carrier should interview immediate supervisors and co-employees to determine the actual use of company vehicles and whether the employee had implied permission to drink and drive that could override "official" or written restrictions.

Moreover, mandatory liability insurance statutes can impact a court's view as to whether a given use is within the scope of permission. Even when a policy limits coverage to permitted uses and the owner has strictly limited the permitted use of the vehicle, state insurance statutes or regulations may otherwise mandate coverage. For example, in *O'Neill v. Long*, the Oklahoma Supreme Court voided an omnibus clause of a Business Automobile Policy that would have otherwise limited coverage only to permitted uses.[10] The court held that allowing an omnibus clause to void coverage for non-permitted uses would "allow[ ] the named insured to create a whole new class of potential uninsured motorists in the State of Oklahoma by restricting the scope of permission granted to a person using the insured vehicle."[11] Given the above, in any case the carrier must review individual state statutes and regulations to determine whether insurance coverage was mandated for the use at hand. If the courts of the state have not previously

resolved potential conflicts between an auto liability statute or regulation and the omnibus clause of a Business Automobile Policy, potential uncertainties as to any coverage position may result.

Larry Lawyer and the "Non-Owned Automobile" Endorsement

A. Vicarious Liability

Coverage issues regarding Larry Lawyer's accident are quite different. The car involved in the accident was not owned by the Bennett, Spence & Darrow law firm so obviously the law firm does not have an insurance policy covering the vehicle. Nonetheless, the Bennett, Spence & Darrow law firm can be held liable for the accident pursuant to *respondeat superior* if Larry Lawyer is found to have been acting within the scope of the law firm's business at the time of the accident. Like most professional firms, the law firm has a Professional Liability Policy with Supplemental General Liability Coverage. These policies typically have an automobile exclusion such as:

This insurance does not apply to:

* * *

> The ownership, maintenance, operation, use, entrustment to others, loading or unloading of any automobile, mobile equipment, watercraft or aircraft owned or operated by, or rented, or loaned to any insured, or any other automobile, mobile equipment, watercraft or aircraft operated by any person.

* * *

This automobile exclusion prevents the insured from converting a Professional Liability Policy into an automobile policy for which the firm obtained separate coverage for its "owned" automobiles.

But that leaves a "gap" in coverage. The firm could nonetheless be sued if an employee, like Larry Lawyer, causes an accident if he is driving his personal automobile within the scope of the law firm's employment. The Non-Owned Automobile Endorsement fills this gap. The typical Non-Owned Automobile Liability Endorsement provides:

* * *

> **Non-Owned Automobile Liability**
>
> In consideration of the premium charged, we will pay all sums an Insured must legally pay as damages because of bodily injury or property damage to which this insurance applies, caused by an accident which occurs during the policy term and results from use of any non-owned automobile in the course of your business by any person other than you, an owner, or partner of your business.
>
> We have the right and duty to defend any suit asking for these damages. However, we have no duty to defend claims or suits for bodily injury or property damage not covered by this endorsement. We may investigate and settle any claim or suit we consider appropriate. Our duty to defend or settle ends when the Limit of Liability specified in this endorsement has been exhausted by payment of judgments or settlements.
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> * * *
>
> **II. Who is an Insured**
>
> A. Each of the following is an Insured with respect to the insurance provided by this endorsement.
>
> 1. You;
> 2. Any partner or executive officer of yours, but only while such non-owned automobile is being used in your business;
> 3. Any other person or organization, but only with respect to their liability because of acts or omissions of an insured under 1 or 2 above.
>
> B. None of the following is an insured:
>
> 1. Any person engaged in the business of his or her employer with respect to bodily injury to any co-employee or such person injured in the course of employment;
> 2. Any partner or executive officer with respect to any automobile owned by such partner or officer or a member of his or her household;
> 3. Any person while employed in or otherwise engaged in duties in connection with any automobile business.
>
> * * *

The coverages offered by the Non-Owned Automobile Endorsement are relatively clear. So long as the employee is operating the vehicle "in the course" of the employer's business, the named insured/employer is covered. The policy also protects partners or executive officers that could be sued on vicarious liability claims. For example, if Peter Partner told Larry Lawyer to drive to a deposition and Peter Partner is named as a defendant as a result of an accident, the policy provides coverage to Peter Partner. In that manner, the law firm's "gap" in coverage is filled.

Importantly, however, the Non-Owned Automobile Endorsement does *not* cover the employee. That is because there should be no "gap" in coverage for the employee that needs to be filled. The employee should have coverage under his or her own automobile policy for the claim. He or she is protected by that policy and the law firm is protected by the "Non-Owned Automobile Endorsement."

B. Direct Liability Claims

More problematic is if the plaintiff sues the law firm for negligent supervision or social host liability as a result of Larry's accident. The negligent supervision claim and the claim that the law firm may have caused one of its employees to be impaired must be examined differently than the

vicarious liability claims. The reason for the separate analysis is because the firm could be faced with "direct" liability even if Larry Lawyer was not within the scope of employment at the time of the accident. These claims may not implicate the Non-Owned Automobile Endorsement because that Endorsement requires that the automobile was being used in the "course" of the law firm's business at the time of the accident.

These "direct liability" claims must first be analyzed by reverting to the provisions of the Professional Liability Policy without reference to the Non-Owned Automobile Endorsement. Because direct liability claims implicate acts or omissions of the law firm that do not involve the maintenance or use of an automobile, they may trigger the general insuring clauses of the Professional Liability Policy and may not be excluded by the automobile exclusion. This is so even though the direct proximate cause of the plaintiff's damages is the automobile accident.

The direct liability claims could also potentially implicate the Supplemental General Liability and Host Liquor Liability provisions of the policy. Such provisions generally provide:

* * *

Supplemental Liability

1. General Liability

   Subject to the Limits for Supplemental Liability specified in the Declarations we will pay on behalf of the Insured all amounts the Insured becomes legally obligated to pay as damages as a result of bodily injury or property damage to which this Insurance applies cause by an occurrence in the operation of the Insured's business.

2. Host Liquor Liability

   Subject to the Limits for Supplemental Liability specified in the Declarations we will pay on behalf of the Insured all amounts the Insured becomes legally obligated to pay as damages because of bodily injury or property damage arising out of the giving or serving of alcoholic beverages at functions incidental to the Insured's business, providing the Insured is not engaged in the business of manufacturing, distributing, selling or serving of alcoholic beverages.

   This coverage will not apply to liability imposed because of a violation of a statute, ordinance or regulation pertaining to the manufacturing, sale, gift, distribution or use of any alcoholic beverage including the selling, serving or giving of any alcoholic beverage to a minor.

* * *

As a threshold matter, both the Supplemental General Liability and Host Liquor Liability provisions require that the accident have some connection to the law firm's business. The Supplemental General Liability coverage provides that there must be bodily injury caused by "an occurrence in the operation of [law firm's] business." The Host Liquor Liability coverage requires that liability be based upon serving alcohol at a "function" that is incidental to the law firm's business.

Notably, neither the Supplemental General Liability or Host Liquor Liability provisions expressly require that the employee causing the accident be within the scope of employment at the time of the accident. The issue now becomes whether the automobile exclusion in the Professional Liability Policy excludes such "direct" liability under the Supplemental General Liability and Host Liquor Liability coverages, such that any coverage under the Professional Liability Policy would be limited to the vicarious liability claims and controlled solely by the Non-Owned Automobile Endorsement.

One line of cases holds that if the proximate, efficient, dominant or direct cause of the loss falls within the automobile exclusion, the policy does not cover the loss. For instance, in *Ruben Contractors, Inc. v. Lumbermens Mut. Ins. Co.*, Ruben Contractors entrusted a vehicle to one of its employees.[12] The employee was supposed to use the vehicle only for work and not for personal purposes. He drove the truck to a wedding and was involved in an accident that injured Gray. Gray sued Ruben on theories of *respondeat superior* and negligent entrustment. Ruben's liability insurer, Lumbermens, refused to defend and indemnify Ruben based upon an exclusion in its policy for any damage caused by the operation of an automobile. Applying Maryland law, the court agreed with Lumbermens that there was no coverage, despite the negligent entrustment claim.[13] Noting a split of authority on the issue of whether liability policies cover claims for negligent entrustment when the policy contains an exclusion for liability arising from the maintenance or operation of a motor vehicle, the court predicted that Maryland would follow the majority view and found that Lumbermens' policy did not cover the claim:

> Maryland has yet to take a position on this issue, but we believe that it would adopt the majority view and find the Lumbermens policy inapplicable. As noted above, Maryland has rejected the policy of construing insurance policies "most strongly against the insurer" in favor of "the rule that the intention of the parties is to be ascertained if reasonably possible from the policy as a whole." The exclusion in the Lumbermens policy is broadly worded and indicates that the policy was not intended to cover any injury resulting from the use of an automobile, irrespective of the theory on which liability

rests. The prevalence of form policies, some applying exclusively to automobile accidents, and others disclaiming them in broad terms, furthers this conclusion.[14]

The *Ruben* court invoked the automobile exclusion, even in the face of negligent entrustment claims that would otherwise be within the scope of coverage.[15]

The view of the *Ruben* court is not universal. For example, in *United States Fid. & Guar. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, a child was injured when she fell from an automobile operated by Happyland Day Care Center.[16] The complaint alleged that Happyland negligently supervised the children and failed to have sufficient staff. It also alleged that Happyland negligently operated the automobile and failed to have appropriate safety devices on the automobile. U.S.F.&G agreed to defend the negligent supervision count under a reservation of rights but brought a declaratory judgment action contending that even the negligent supervision claims were excluded pursuant to an exclusion in the policy regarding the maintenance or use of an automobile. Relying on case law from California[17] and Louisiana,[18] the Appellate Court of Illinois held that the negligent supervision claims were covered.[19] It believed that the negligent supervision claims were "unrelated to the operation or use of the motor vehicle" such that U.S.F.&G had an ongoing duty to defend the claims.[20]

When reviewing any claim or complaint, it is very important to analyze the nature of the claim and the acts or omissions that are the basis of that particular claim. When the policy contains a Non-Owned Automobile Endorsement, there unquestionably will be coverage for the vicarious liability claims against the employer. Claims of social host liability, negligent hiring or negligent supervision, however, state causes of action which are potentially distinct from the automobile liability claims. Whether those claims are covered or excluded will require an analysis of the law of the involved state.

Should the Carrier Defend?

Aside from the indemnity coverages, whether the carrier has a duty to defend the employee in the suit is an important issue that must be addressed.

Typically, no matter what the jurisdiction, the carrier will be required to defend if the "four corners" of the complaint would implicate coverage under the "four corners" of the policy. In situations like our hypotheticals, the allegations of the complaint will typically not have anything to do with reality. The plaintiff may allege that Larry Lawyer or Mike Manager were within the scope of employment at the time of the accidents, when clearly neither were. With regard to the duty to defend these claims, a review of the complaint should answer the question. In the case of the omnibus clause, if the complaint alleges scope of employment and/or permissive use of the vehicle, it is likely that a court would find a duty to defend. With regard to the Non-Owned Automobile Endorsement, if the complaint alleges that the employee was acting within the scope of employment, there will be a duty to defend the employer or partners or executive officers sued on vicarious liability theories, but no duty to defend the driver/employee because the driver/employee can never be an insured under the policy.

As a practical matter, where there is no duty or doubtful duty to defend, the decision as to whether to defend may be a strategic one. The resolution of this issue may depend in large part on how state law would treat settlements between the plaintiff and the putative employee/insured. If they settle, is that settlement binding in a later coverage suit against the carrier?

If the carrier disclaims coverage, the plaintiff and the putative insured are in a bind. The plaintiff does not want to go through the time, expense and risk of a full trial only to find that the defendant ultimately has no coverage. The obvious solution is an agreed judgment against the defendant whereby the plaintiff/claimant agrees not to execute that judgment against the insured's assets. In this manner, the insured and the claimant can then pursue the coverage claim against the insurance carrier, but the insured does not face the risk of exposing his own assets. Alternatively, the claimant and the defendant insured may go through a "sham" trial, *i.e.*, the claimant pursues the claims which are covered and the defendant insured either does not vigorously defend the claim or only defends those portions of the claim which would not be covered by the insurance policy.

In situations such as these, the issue becomes under what circumstances such covenants and assignments or judgments as a result of "sham" trials are binding upon the insurance carrier. There are three possible options regarding whether the carrier can contest the resolution of the underlying action. Having refused to provide a defense:

1. the insurance carrier is estopped from contesting liability or damages decided in the underlying action if it turns out there is actually coverage under the policy; or
2. the carrier can contest liability and damages, but the insured and the third-party tortfeasor need to establish that the settlement was fair and reasonable; or
3. the carrier is not bound by the resolution of the underlying action and can contest liability and damages in the subsequent coverage litigation.

Some courts have held that the insurer is bound only by the outcome of a "full adversarial trial." In *State Farm Fire & Cas. Co. v. Gandy*, the Texas Supreme Court held that an agreed judgment, coupled with an assignment and a covenant not to execute against the insured's assets, violated public policy.[21] First, the court believed that such a collusive settlement and assignment would not terminate litigation but rather would

extend and encourage future litigation.[22] Second, the court noted that such settlements would greatly distort the litigation that followed.[23] This is particularly true when, as in *Gandy*, the insured initially denied any liability for the claimant's claim, but then later agreed to have judgment entered against it. Allowing the agreed judgment to stand would perpetuate a "fraud" and an "untruth."[24] The Texas Supreme Court thus held:

> [T]he defendant's assignment of his claims against his insurer to a plaintiff is invalid if (1) it is made prior to an adjudication of plaintiff's claim against defendant in a fully adversarial trial, (2) defendant's insurer has tendered a defense, and (3) either (a) defendant's insurer has accepted coverage, or (b) defendant's insurer has made a good faith effort to adjudicate coverage issues prior to the adjudication of the plaintiff's claim. We do not address whether an assignment is also invalid if one or more of these elements is lacking. *In no event, however, is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding upon defendant's insurer or admissible as evidence of damage in an action against defendant's insurer by plaintiff as defendant's assignee*.[25]

The *Gandy* case exemplifies the importance of offering a defense to an insured if there is any question as to coverage. *Gandy* does, however, offer some protection to the carrier. Carriers will not have to pay judgments without being entitled to contest liability or damages unless there has been a good faith adjudication of the underlying action. When no defense is offered, there is a greater possibility that a court will view that the insured has been hung out to dry by the carrier and, if there was even a facial trial, it may be difficult for the carrier to argue that the trial was not bona fide. The parties can simply go through a trial with the insured putting on little or no case and then enter into a covenant not to execute or assignment that could be binding upon the carrier. Therefore, if there are any legitimate questions to coverage, it is the better part of valor for the carrier to provide a defense; otherwise, the carrier may be stuck with a less than desirable outcome.

On the other hand, other jurisdictions hold that if the carrier refuses to defend, it can only attack the settlement if it is collusive. This is the law in Arizona, which follows the doctrine set forth in *Damron v. Sledge*.[26] In *Damron*, the plaintiff sued Sledge and Polk. Sledge was driving Polk's car at the time of the accident. Polk's carrier, National Union, refused to defend Sledge because it believed he was not a permissive user of the vehicle at the time of the accident. At trial, Sledge entered into a covenant not to execute with the plaintiff and assigned his rights as to any bad faith claim. The trial court dismissed Damron's claims, holding that any trial by Damron against Sledge after the covenant not to execute would be collusive.

The Arizona Supreme Court reversed, holding that the trial would not necessarily have been collusive and should have gone forward.[27] The court held that when an insurance carrier breaches its duty to defend, an agreement between the plaintiff and the insured not to execute on the insured's assets and taking an assignment against the carrier is not *ipso facto* collusive.[28] In doing so, the court relied upon a California decision, *Critz v. Farmers Ins. Group*, quoting extensively from that decision in adopting this approach:

> When the insurer breaches its obligation of good faith settlement, it exposes its policyholder to the sharp thrust of personal liability. At that point, there is an acute change in the relationship between policyholder and insurer. The change does not or should not affect the policyholder's obligation to appear as defendant and to testify to the truth. He need not indulge in financial machismo, however. Whatever may be his obligation to the carrier, it does not demand that he bare his breast to the continued danger of personal liability. By executing the assignment, he attempts only to shield himself from the danger to which the company has exposed him. He is doubtless less friendly to his insurer than he might otherwise have been. The absence of cordiality is attributable not to the assignment, but to his fear that the insurer has callously exposed him to extensive personal liability.
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> * * *
>
> To uphold an equitable assignment under such circumstances does not supply the injured party with a disproportionate or unfair advantage. In our opinion, the present assignment is not violative of public policy if in fact a bad faith rejection had already occurred. If, on the other hand, the carrier was not guilty of bad faith, the plaintiff-assignee will lose the lawsuit regardless of the public policy aspects of the assignment.[29]

The *Damron* court held that "the assignment in the instant case was not *ipso facto* collusive."[30]

The *Damron* court noted that if the insurer did not want to risk an agreement of the type entered into, it should have defended under a reservation, noting: "Where the carrier sends its insured a notice that it is reserving its rights to contest liability for any judgment, and then goes ahead and defends the action, it is almost uniformly held that by this notice the company may defend and use its

best efforts to prevent an excessive verdict."[31]

Thus, if the employee has *any* argument as to coverage, the best course of action is for the insurer to defend the employee under a reservation of rights. If the facts that could resolve coverage issues can be addressed prior to the resolution of the underlying claim, the carrier should also strongly consider filing a declaratory judgment action to have its rights determined as soon as possible.

Applying this case law to the hypotheticals, the duties to defend are relatively clear. Plaintiff #1 has alleged that Larry Lawyer was within the scope of his employment at the time of the accident. The carrier therefore must defend Bennett, Spence & Darrow because, if Larry Lawyer was within the scope of employment at the time of the accident, coverage is afforded the firm under the Non-Owned Automobile Endorsement for that claim. There may or may not be coverage for the social host liquor liability claim, depending upon the law of the jurisdiction governing coverage. In most states, however, because the carrier must defend the vicarious liability claims, it must defend the entire suit. The carrier nevertheless should issue a reservation of rights letter to the law firm regarding coverage for the direct liability claims and the fact that the claim may not be covered under the Non-Owned Automobile Endorsement if the fact finder determines that Larry was not within the "course of business" of the law firm at the time of the accident. There is no duty to defend Larry Lawyer under the Endorsement because he does not qualify as an insured under the Endorsement. If Larry Lawyer tenders a defense, the carrier should strongly consider providing a courtesy defense and/or filing a declaratory judgment action early on to have that matter resolved rather than simply waiting until after a stipulated judgment or verdict against Larry Lawyer.

With regard to the claims against Mike Manager, Plaintiff #2 did not sue the law firm and therefore it is unlikely that issues of permissive use or scope of employment would be referenced in the complaint so as to trigger the duty to defend. If the lack of a permitted use is clear cut, then the carrier could disclaim coverage and the duty to defend based upon its own investigation. The carrier, however, may wish to defend this suit under a reservation in order to avoid having the coverage issues decided only after a verdict or stipulated judgment against Mike Manager.

Endnotes

1. A jurisdiction by jurisdiction summary is beyond the scope of this paper in that it is assumed complete research will be performed regarding the jurisdiction where the claim arose. An excellent summary of the various cases on permissive use is contained in C.T. Dreschler, *Automobile Liability Insurance: Permission or Consent to Employee's Use of Car Within Meaning of Omnibus Coverage Clause*, 5 A.L.R.2d 600 (Supp. 2007).
2. 875 A.2d 943 (N.J. 2004).
3. *Id.* at 948 (quoting *Verriest v. INS Underwriters*, 662 A.2d 967 (N.J. 1995)).
4. *Id.* (quoting *Matits v. Nationwide Mut. Ins. Co.*, 166 A.2d 345, 353 (N.J. 1960)).
5. 289 N.W. 227 (Mich. 1940).
6. 161 A. 496 (Me. 1934).
7. 596 S.W.2d 502 (Tex. 1980).
8. *Id.* at 505.
9. *Id.*
10. 54 P.3d 109 (Okla. 2002).
11. *Id.* at 114.
12. 821 F.2d 671 (D.C. Cir. 1987).
13. *Id.* at 677
14. *Id.* (internal citations omitted).
15. The *Ruben* court's holding was subsequently ratified by the Maryland Supreme Court in *N. Assurance Co. v. EDP Floors, Inc.*, 533 A.2d 682 (Md. 1987).
16. 437 N.E. 2d 663 (Ill. App. Ct. 1982).
17. *State Farm Mut. Ins. Co. v. Partridge*, 811, 514 P. 2d 123 (Cal. 1983).
18. *Johns v. State Farm Fire & Cas. Co.*, 349 So. 2d 481 (La. Ct. App. 1977); *Frazier v. State Farm Mut. Auto. Ins. Co.*, 347 So. 2d 1275 (La. Ct. App. 1977).
19. 437 N.E. 2d at 667.
20. *Id.* at 666.
21. 925 S.W.2d 696, 698 (Tex. 1996).
22. *Id.* at 715.
23. *Id.*
24. *Id.* at 705.
25. *Gandy*, 925 S.W.2d at 714 (emphasis added).
26. 460 P.2d 997 (Ariz. 1969).
27. *Id.* at 1000.
28. *Id.* at 999.
29. *Id.* (quoting 41 Cal. Rptr. 401 (Cal. Ct. App. 1964).
30. *Id.*
31. *Id.* at 1001.