

Rental Car Contracts Raise Coverage Stakes

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Your client calls to tell you he'll be renting a car while vacationing in San Diego next week. He won't buy the coverage the rental company offers if his own policy covers most of his exposures. His brother-in-law told him the rental company coverage is a "big rip-off." What do you tell him?

Most agents are aware that a standard personal auto policy does not cover all rental-car exposures. There's a gap between a renter's responsibility under the rental contract and what an auto policy will pay. If, as is most common, damage to the rental car is covered under the auto policy's physical damage section, the insured will certainly have to pay the deductible and at least a portion of the loss-of-use charge. Considering the price of rental company coverage, agents often suggest that a client consider retaining this uncovered portion.

But today the gap has widened. Two revisions in rental-car contracts have significantly increased the renter's portion of the risk. One is an added charge for "diminution in value" whenever a rental car is repaired. The other is "before and after," a method of determining the renter's responsibility when a car is substantially damaged.

Diminution in value

About five years ago, rental companies began holding the renter liable for a "diminution of value" charge when a rental car was damaged. This charge represents the reduction in a vehicle's market value due to its having been in an accident.

When the repaired car is eventually sold, it brings a lower price. When a renter returns a vehicle in damaged condition, he or she receives one bill for repairs and another for diminution in value. Most auto policies cover most of the repairs, but few cover diminution in value. This exclusion was introduced for the personal auto policy in 1999, with one for commercial auto a few years later.

There has also been extensive litigation addressing how coverage applies in the absence of an exclusion. Most courts have found policies do not cover the exposure, so the renter can expect to self-insure for diminution in value. Unfortunately, that's not the end of the story.

Before and after

Diminution in value is a concern when the rental company repairs a damaged vehicle—but today many cars are never repaired. With some types of damage, liability concerns make rental companies reluctant to return a repaired car to the fleet. Instead, they simply sell the damaged car for salvage. They then charge the renter the difference between the market value on the day of rental ("before") and the amount the car brought at the salvage auction ("after").

The following language is found in the contract of a major rental car company: "If the car is damaged, you will pay our estimated repair cost, or if, in our sole discretion, we determine to sell the car in its damaged condition, you will pay the difference between the car's retail fair market value before it was damaged and the sale proceeds."

A recent Michigan example illustrates this practice. The insured rented a Ford Freestar with an estimated market value of \$26,500 and brought it back damaged. The cost of repairs, loss of use and appraisal fee totaled \$7,800. The rental company chose not to repair the vehicle but to sell it at a salvage auction, where it brought only \$11,700. The renter received a bill for about \$14,800, or the difference between the before and after values. The renter's auto policy paid only the estimated repair costs, leaving a balance of almost \$7,000. That became the responsibility of the renter - quite a significant self-insured retention.

"Both provisions are being added to all rental contracts," stated Jim Maher of Midwest Car Corp. The company holds a 17-city franchise for two major rental car lines. He added that since the renter has signed a legally binding contract, rental companies have no difficulty collecting. As these new provisions are activated, the gap between what the renter owes and what his or her insurance will pay has become too wide to ignore. How can it

be covered? Don't look to the insurance industry. Those few companies still covering damage to a rental car under the liability section of the auto policy may be obligated to pay the entire bill. However, when coverage is found only under the physical damage section, most insurers will not accept responsibility for the additional charges. Do not expect them to create a new coverage to address the added exposures, because these risks are not easily addressed by insurance.

Isn't some coverage for damage to a rental car included with a credit card? Only some credit cards provide any coverage for a rental car. It's generally excess over the renter's auto policy, and payment is limited to the cost of repairs. A renter should not expect a credit card company to pay diminution in value or before-and-after charges.

Regardless of what the brother-in-law thinks, there's really only one place renters can obtain full coverage, and that's through the purchase of the loss damage waiver offered by the rental car companies.

The loss damage waiver

Rental-car companies hold the renter responsible for all damage to the rental car, including an act of God. If a tree totals the rental car during a severe windstorm, the renter is liable. The rental company will waive its right to hold the renter responsible if he or she pays an additional fee and abides by the terms of the waiver. This waiver, which is not insurance, can add between \$15 and \$30 per day to the cost of the rental.

With the waiver, the renter will not be liable for any damage to the vehicle. He or she will not be charged for repairs to the vehicle, for diminution in value, for before-and-after assessments or for loss of use. The renter can walk away from all responsibility for damage to the vehicle as long as he or she has not engaged in any prohibited use.

All rental car waivers have a clause voiding the waiver if the renter improperly operates the vehicle at the time of the accident. Although wording varies, most waivers prohibit reckless or intoxicated use or use off paved roads. There is no coverage if an unauthorized driver uses the vehicle, so handing the keys to a valet parking attendant voids the waiver. Theft of the vehicle is not covered if the keys are left in the car or if the vehicle is unlocked.

Buying the loss damage waiver is the only way to close the significant rental car gap that now exists. A renter must weigh the benefits against the cost. The renter who purchases the waiver should review the prohibited use provisions and avoid engaging in any activity that would void the waiver.