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Peer to Peer 4

**Before a Claim Happens: Designing Leases and Construction Contracts to Properly Allocate Risk**

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Reusing a tried and true insurance provision can create unintended problems, unlike most provisions in leases and construction contracts without considering whether that provision is correct or appropriate at the time of negotiation or properly allocates the risk. With the changes in insurance terms in the past 30 or so years, it is not uncommon to be confronted with insurance requirements that may have been correct when the lease was executed but that are now outdated.

In addition insurance companies are attempting to restrict coverage to additional stakeholders (from who they are not receiving any premium dollars) by limiting coverage for additional insureds to what is specifically required in a contract. Carriers also rely on the contract to determine insurable interest, even for locations listed on a policy for which they are receiving premium.

Although types of losses may differ and their contractual underpinnings may vary, insurance company adjusters generally ask three questions to determine whether insurance coverage is available.

These key questions are:

- Is the entity seeking insurance coverage, or from whom coverage is sought, listed on the insurance policy?
- Is the location at which the loss or damage occurred listed in the insurance policy?
- Is the person or entity against whom the claim is made contractually responsible for the location or claim?

**FACT PATTERN 1**

A shopping center owner leases and a restaurateur enter into a NNN lease for a pad building. Both parties determine that the landlord should purchase the building insurance as they have a master insurance program and more purchasing power. Eight months into the lease there is a kitchen fire which destroys much of the kitchen and 15 percent of the structure. The restaurant will be closed until all the repairs are made. The tenant submits a claim to their insurance company for their interests in the claim. The landlord submits a claim to their insurance policy for the building damage.

Despite the business discussion the signed lease contains the following insurance requirements:

Tenant's Liability Insurance. Tenant shall, at its sole expense, obtain and keep in force during the Term a commercial general liability policy of bodily injury and property damage insurance insuring Landlord and Tenant against any liability arising out of the use, occupancy or maintenance of the Premises by Tenant. Such insurance shall be a combined single limit policy in an amount not less than One Million Dollars (\$1,000,000) per occurrence and Two Million Dollars (\$2,000,000) in the aggregate, plus an umbrella liability policy in an aggregate amount not less than Five Million Dollars (\$5,000,000). Such insurance shall name Tenant as the named insured and Landlord (and any property manager or mortgagee of Landlord of which Tenant has received written notice) as an additional insured. Tenant shall maintain worker's compensation insurance in amounts required by law.

Landlord's Liability Insurance. Landlord shall obtain and keep in force during the Term a commercial general liability policy of bodily injury and property damage insurance insuring Landlord against any liability arising out of the ownership, use, occupancy or maintenance of the entire Shopping Center, which insurance shall be a combined single limit policy in an amount not less than One Million Dollars (\$1,000,000) per occurrence and Two Million Dollars (\$2,000,000) in the aggregate, and in no event shall Tenant be obligated to reimburse or contribute to Landlord's Insurance liability coverage which is in excess of Two Million Dollars (\$2,000,000) per occurrence and Five Million Dollars (\$5,000,000) in the aggregate.

Tenant's Property Insurance. Tenant shall obtain and keep in force during the Term, at Tenant's expense, a full replacement cost fire and extended coverage policy or policies of insurance covering loss or damage against "all risk" of physical loss to Tenant's personal property. During the Original and any Extension Terms, Tenant agrees to keep in effect on the Leased Premises fire insurance with an extended coverage endorsement in an amount not less than one hundred percent (100%) of the replacement cost (excluding costs of replacing excavations and foundations but without deduction for depreciation) of the building structure and other improvements thereon. Tenant will also procure insurance for Tenant's personal property located within and about the Premises, including, Tenant's merchandise, trade fixtures, equipment, building and monument signage, and furniture (collectively, "Tenant's Removable Personal Property"), in the amount of the full replacement value thereof, less any applicable deductibles.

#### QUESTIONS FOR FACT PATTERN 1:

1. What language is missing from the tenant's insurance requirements that may have an impact on this claim?
2. Does the landlord have insurable interest in this claim?
3. What language is missing from the landlord insurance requirements?

#### FACT PATTERN 2

A landlord hires a general contractor to construct a restaurant on a pad at their shopping center. The landlord provides the insurance requirements below in their contract.

During the Term of this Agreement, Contractor shall maintain the following insurance:

Commercial general liability insurance including coverage for bodily injury, property damage, and contractual liability all in an amount not less than \$1,000,000 per occurrence/\$2,000,000 aggregate; Worker's compensation insurance at statutory limits, if applicable, and Commercial (Business) Automobile Liability for an amount not less than \$1,000,000 per occurrence/\$2,000,000 aggregate, if Contractor has company-owned vehicles that are driven onto the Property,

Contractor's commercial general liability policy and commercial (business) automobile liability policy shall name Owner as additional insureds.

Contractor's commercial general liability policy and commercial automobile liability policy shall be endorsed to make such insurance primary to any liability insurance maintained by Owner or Owner's property manager.

#### QUESTIONS FOR FACT PATTERN 2:

1. Is there wording that could be added to the general liability section that can strengthen this requirement and better protect the owner?
2. Is the auto requirement strong enough to protect the owner?
3. Are the limits of insurance that are being requested of the contractor sufficient?
4. Does the additional insured requirement adequately transfer risk to the contractor?