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Workshop 19

Drafting Lease Insurance Requirements: You Can't Always Get What You Want, But Did You Get What You Need?

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by:

Bryant Eaton
Senior Vice President
Alliant Insurance Services, Inc.
1301 Dove Street, Suite 200
Newport Beach, CA 92660
beaton@alliant.com

Scott B. Osborne
Foster Garvey, PC
1111 Third Avenue
Suite 3000
Seattle, Washington 98101
scott.osborne@foster.com

A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines. With consistency a great soul has simply nothing to do.

Ralph Waldo Emerson
Mr. Emerson's response to landlord's counsel who refused to modify insurance provision in Emerson's retail lease because "we never change the form."

Introduction

Insurance provisions in retail leases create special challenges. These provisions must be coordinated with the risk allocation between the landlord and tenant. Under a garden variety shopping center lease, risk of loss associated with events associated with the building and the common areas is normally allocated to the landlord and the tenant is responsible for losses occurring in its premises, arising from its operations and any losses associated with tenant's property. However, the insurance provisions of most leases do not completely support this allocation for the following reasons.

- Outdated Insurance Language: With the changes in insurance terms in the past 30 or so years, it is not uncommon to be confronted with insurance requirements that may have been correct when the lease was originally executed but that are now outdated. "Comprehensive General Liability" insurance became "Commercial General Liability" insurance more than 30 years ago; a desire for an "all-risk" insurance policy (it never was) should now specify "special form causes of loss" policy form.

- Outdated Insurance Limit Requirements: Many leases still only require that each party provide $1,000,000 per occurrence general liability limits. The cost of liability claims has risen dramatically since the 1980s and 1990s when $1,000,000 was a common requirement.

- Missing Coverage Requirements: Many leases only contemplate traditional property (building, business personal property, general liability, workers compensation) and neglect other important aspects of coverage such as non-owned auto and business interruption.

- Updated ISO Forms: In 2013 ISO updated its forms restricting coverage provided to additional insureds to what coverage is explicitly required in a written contract. These restrictions were continued in the further changes made in 2019.

- Current Legal Climate: Vague insurance requirements with policies provided by landlords and tenants are an invitation for claimants to seek access to multiple insurance policies, thereby defeating the risk allocation scheme between landlord and tenant embodied in the lease.

- Waivers of Subrogation: These provisions are often "boilerplate," attracting little attention during the drafting process resulting in waivers not coordinated with insurance policies and not reflecting the risk allocation negotiated by the landlord and tenant.

Once the lease is signed each party must verify that their respective insurance policies meet the terms of the lease and confers any insured status that the lease requires. Does a standard Acord Form certificate address the intentions of both parties? Does the certificate convey any value or is it information only?

The goal of this workshop is to identify the must haves for the insurance section of your next lease and how you can verify the parties actually receive the benefit of their negotiations.

I. Keeping Insurance Language Up to Date. While "forms" often include standard insurance requirements, actual risk is determined by the type of agreement and the nature of the operations and activities to be performed under the agreement. Insurance is a form of financing. Any insurance policy provides a source of payment for the liabilities and risks allocated between the parties in the lease agreement. It is important to remember the landlord and tenant do not "allocate" risk to the insurance company; they allocate risk among themselves and then specify the types of insurance each requires so there is a source of payment in the event liabilities are incurred. Specifying insurance coverage does not limit the risk assumed by the insured party under a lease; similarly, not all risks assumed by a party to a lease are covered by insurance.

A. Vocabulary: Insurance has its own vocabulary; unfortunately the vocabulary changes rather frequently, requiring a periodic review of insurance provisions to avoid using outdated terms or term whose meaning has changed through various policy iterations. There are some reoccurring terms found in forms requiring attention to avoid ambiguities and future disputes.

(1) Avoid "casualty insurance" when describing the insurance intended to pay the owner for replacement of a building if it is damaged or destroyed by a risk covered by the policy. The correct term is "property insurance." Using "casualty insurance" to refer to "property insurance" creates ambiguity because insurance professionals often use "casualty insurance" to refer to insurance intended to pay for the defense and liability arising from third party accidents – in other words, to refer to "liability insurance." Certainly, a "casualty" may trigger a claim under a property policy, but it also refers to accidents such as slips and falls on the property. Be careful when using the term "casualty," and don't refer to a "casualty policy" in a document since it could mean either a "liability policy" or a "property policy," depending on the sophistication of the court.

(2) Avoid "co-insured" when referring to another party intended to receive the benefits of a property policy or liability policy. This term does not mean an additional named insured, an additional loss payee, or an Additional Insured. Technically, the term "coinsurance" is used to describe penalties in property policies causing the insured to share the loss with the insurer under certain circumstances, such as under-insurance.

(3) Avoid "personal injury" - this is a term of art in insurance policies - unless you intend it to mean personal injury which includes false arrest, detention, or imprisonment; malicious prosecution; wrongful eviction; slander; libel; and invasion of privacy. The risk the parties are probably trying to address is most likely "bodily injury."

B. Preliminary terms:

(1) Coverage Limit**:** The location and type of risk, and the amount of coverage in current dollars, should each be considered in determining required coverage limits. As an example of a time-based calculation, $1,000,000 in 1990 equals $2,000,000 today, so longer term agreements will typically include a right to adjust coverage requirements over time.

Insurance advisors can assist in developing a limit matrix recommending different limits for different sized risks and/or different types of operations.

(2) Deductible vs. Self-Insured Retention**:** While both a deductible and a self-insured retention represent portion of a risk allocated to the insured for which there may be no source of payment provided by the insurance policy, the contractual responsibility of the insurance company varies with each.

(a) With a deductible, the insurer is responsible for the claim regardless of whether the deductible is collected from the insured or not. In other words, the insurer pays the deductible amount to a third party making a claim, but then collects the deductible from the insured.

(b) In contrast, the insurer is not responsible for payment of any loss until the insured satisfies the self-insured retention. Because of this, for losses exceeding the amount of the self-insured retention, the landlord/tenant (as the case may be) may want to satisfy the portion of the loss equal to the self-insured retention under a policy maintained by a financially challenged tenant/landlord as a means of accessing insurance which may be otherwise unavailable.

(3) Per location aggregate limit**:**

(a) A tenant or landlord operating at multiple locations will require a per location aggregate limit of insurance. The per-location aggregate limit prevents the insured's limit of insurance from being diluted by the number of locations it operates.

(b) The requirement of a per-location aggregate limit also applies to contractors and others providing services at multiple locations. The aggregate limit should apply on a per project basis and the policy limits should not be spread among all locations; if the per location aggregate limit is not in effect, a large loss and claim at one location could exhaust coverage otherwise available at the subject property location.

(4) Whose insurance is primary? Each party will want the other party's insurance to be the first to cover any claim, with the objective of having one's coverage applicable only if the other party's insurance is exhausted. An endorsement to assure that the standard Business Auto policy is primary is not generally required, as primary insurance language is written into the standard policy form. Such an endorsement is recommended for commercial general liability insurance policies, especially for high-risk operations or activities. Lease agreements, services contracts and other agreements will frequently clarify which party's insurance is primary; such primacy may vary based on, for example, whether the loss occurs in common areas or in a tenant's premises.

C. A Menu of Policy Options – There are several types of policies usually required under a retail lease or a contract for construction of real property improvements:

(1) Commercial General Liability - Insures the covered risks of bodily injury (including death) and damage to the property of a third party. This is "third party coverage" intended to pay defense costs and insured liability amounts for which the insured property or business owner – or the Additional Insured – becomes obligated to pay to a third party if there is an accident on the property.

(2) Umbrella insurance – Provides excess liability coverage above the limits of the insured's underlying coverages for, by way of example, general liability, automobile and employer's liability.

(3) Commercial Automobile Liability –Owned, Hired and Non-Owned: Provides bodily injury and property damage coverage associated with an automobile accident or other vehicle damage.

(4) Non-Owned Auto Insurance**:** The requirement of non-owned auto insurance is often hotly debated, although insurance advisors frequently note it is inexpensive to purchase. Non-owned auto insurance affords a source of funds for loss and damage caused when, for example, a tenant employee or principal causes an accident when using a personal vehicle in the common areas of a shopping center.

(5) Property Insurance - Insures covered damage to owned property or leased property, and still at times referred to as "casualty insurance" (see ¶ I(a) above). Property insurance is “first party coverage” intended to reimburse the Named Insured, generally the property owner, for the replacement cost (or actual cash value) of its insured property if that property is damaged or destroyed by a “Covered Cause of Loss.”

(6) Builder’s Risk Insurance – Similar to Property Insurance but used during the course of construction or renovation.

(7) Business Income Insurance. This form of insurance provides a source of funds to replace business revenues during the period of restoration after a casualty when the insured is not able to operate or operates at a reduced capacity. Landlords are interested in this coverage, since it the tenant with the ability to continue paying rent to the landlord. This coverage is also available to the landlord to replace rental income lost as a result of physical damage to the insured property if the damage results in rental abatement.

(8) Liquor liability insurance coverage. Most states require that establishments that serve alcoholic beverages carry liquor liability insurance. This requirement, whether or not the beverages are served in a jurisdiction requiring such insurance, should be included in any lease or license as a condition of the service of alcoholic beverages. The service provider itself has a material interest in carrying such insurance as a source of funds for liability claims arising from alcoholic beverage service. If the tenant serves alcoholic beverages, it has an independent interest in maintaining appropriate insurance. Claims arising from alcoholic beverage service can arise from incidents (such as a car accident) arising far from the location of service. The parties should note liquor liability insurance does not typically provide coverage for beverages that are served illegally – for example, to a minor. A prudent landlord will require, and a prudent tenant or user will maintain liquor liability insurance coverage when a business sells, distributes or manufacturers liquor. A lease will also prohibit the service, sale and distribution of alcoholic beverages in contravention of applicable legal requirements.

(9) Worker’s compensation insurance**:** Worker’s compensation insurance is required by statute in most jurisdictions, but such requirements may not apply to small businesses. The insurance provides compensation for medical expenses and lost wages due to an employee’s work-related injury. Without worker’s compensation insurance, any bodily injury that an employee suffers in the common area may end up resulting in a claim against the landlord’s insurance policy. A commercial general liability insurance policy will typically contain an exclusion for claims covered by worker’s compensation insurance.

(10) Employer’s liability insurance: A second typical commercial general liability insurance exclusion is for claims that would be covered by employer’s liability insurance; such insurance provides coverage for liability arising out of an employee’s work-related injury that is not covered by worker’s compensation insurance – for example, for litigation and third-party claims.

(11) Pollution. Although not frequently considered in the retail context, operations posing an environmental risk should have pollution/environmental liability insurance. For example, a business that sells chemicals, paints and solvents, a gas station, and big box and hardware stores will typically carry merchandise that carries pollution risks. In addition, a location’s heavy sanitation requirements increase environmental risk, as does a requirement to use and dispose of environmentally sensitive materials, including medical materials and medical waste. In addition to requiring pollution insurance, a lease agreement will often

also include specific protocols to manage risk. Maintenance of coverage should be required for at least two years after termination of the lease (and possibly more) if written as a claims-made policy.

(12) Specialty insurance in general. The construction, renovation and operation of a location should all be considered in determining requirements for specialty insurance. Specialty insurance would generally be required, and property and liability policies would generally exclude coverage for, jewelry, art work, special events and entertainment, certain construction activities such as the use of cranes. While the requirement for specialty insurance is often an afterthought, the risks and costs that would otherwise be without coverage can be substantial.

II. A Menu of Insurance Limit Requirements. While many forms include standard insurance requirements, actual risk is determined, among other things, by the type use and activity. Appropriate insurance requirements can best be considered when understanding the certain options. One option to including insurance requirements in the document itself is to include the requirements in a separate exhibit. Some examples of regularly employed and currently applicable requirements follow:

Lease Agreements: Each of the following merely provide examples, and each should be tailored to the specific actual use and any needs for specialty insurance, liquor liability insurance, etc. Some lease provisions still require that the tenant carry CGL insurance with limits of liability such as "$1,000,000 for bodily injury, $1,000,000 for property damage, $1,000,000 for contractual liability and $1,000,000 for completed operations." But for almost 30 years, insurance limits have not been expressed this way.

A. CGL insurance limits are instead expressed as being per occurrence, with two different annual aggregates. The per-occurrence limit caps the insurer's liability for any occurrence that is covered by the policy. The aggregate limits are the maximum amount that the insurer is obligated to pay during the policy period for all occurrences together. The insurer will also stipulate a general aggregate limit that applies to all covered claims other than those that are brought in a products-completed operations matter and a separate limit that caps only product-completed operations claim amounts.

(1) A standard commercial lease for a lower risk tenant such as an apparel store may require the tenant maintain the following insurance:

(a) Workers' Compensation/Employer's Liability:

- Coverage A: (Worker's comp) — Statutory Benefits
- Coverage B: (Employer's liability) — $1,000,000 each accident
  $1,000,000 policy limit
  $1,000,000 each employee

(b) Commercial Automobile Liability – Owned, Hired and Non-Owned:
$1,000,000 combined limit

(c) Commercial General Liability:

- Each Occurrence: $1,000,000
- Personal & Advertising Injury: $1,000,000
- Products & Completed Operations: $2,000,000
- General Aggregate: $2,000,000

(d) Umbrella:

- Each Occurrence: $1,000,000
- Personal & Advertising Injury: $1,000,000
- Products & Completed Operations: $1,000,000
- Aggregate: $1,000,000

(e) Property Insurance:

- Special form causes of loss in an amount equal to full replacement of the personal property, contents, inventory, improvements & betterments per contract, and Business Interruption with 365 days extended period of indemnity. Waiver of Subrogation included against landlord for losses payable under such property policy.

(f) Business Interruption Insurance.

- 365 days extended period of indemnity.

(g) Builder's Risk Insurance:

- With minimum limits in the amount that will cover full construction costs on a completed value basis.

(2) Standard Commercial Lease Agreement (Mid Risk Occupancy, e.g. restaurant/food service, warehouse, light industrial, etc.):

(a) An advisor would recommend, at a minimum, increasing umbrella liability limits to $5,000,000.00.

(3) Standard Commercial Lease Agreement (Higher Risk Occupancy, e.g. department store, supermarket, heavy industrial, etc.):

(a) An advisor would recommend, at a minimum, increasing umbrella liability limits to $5,000,000.00.

(4) Commercial Lease Agreement with Liquor Exposure:

(a) Add Liquor Liability

(b) No exclusions or limitations for Assault & Battery

(5) Commercial Lease Agreement with Liquor Exposure (Big Box):

(a) Add Liquor Liability

(b) No exclusions or limitations for Assault & Battery

(6) Commercial Lease Agreement with Pollution Exposure:

(a) Add Pollution Legal Liability Insurance

(b) Pre-Existing and New Conditions: $2,000,000 each occurrence

(c) Pre-Existing and New Conditions: $4,000,000 aggregate

(7) Ground Lease Agreement:

(a) Property coverage should be maintained for the structure and improvements in addition to the tenant's personal property, contents, inventory, improvements & betterments. Flood, if the property is located in a Special Hazard Flood Zone as defined by FEMA. Earthquake, if the property is located in an area with high seismic activity.

(b) During construction, Builder's Risk, with minimum limits in the amount that will cover full construction costs on a completed value basis. Flood, if the property is located in a Special Hazard Flood Zone as defined by FEMA. Earthquake, if the property is located in an area with high seismic activity. Coverage should be included for business interruption/delay in opening.

(8) Additional Insureds. An "Additional Insured" is a party covered under the policy by reason of a contract obligating the Named Insured to add that party as an "Additional Insured." Landlords should require their tenants to maintain CGL coverage with specified limits of coverage; however, to really benefit from that coverage, landlords need to require their tenants to name them as "Additional Insureds" on the required policies. Depending upon the circumstances, a tenant may want similar status on the landlord's CGL policy or on the CGL policy maintained by the property manager.

A party to a lease should not ask to be a "Named Insured" or "Additional Named Insured" on the other party's insurance policy. First, a party not obtaining the policy cannot be a "Named Insured" because that category is restricted to policy owner and its family of affiliates maintaining the policy. Furthermore, the "Named Insured" is subject to all of the defenses to coverage in the policy and subject to denial of coverage if the policy provisions are breached, exposing the party to a loss of coverage if the owner of the policy breaches the insurance contract. Second, reference to becoming a "Named Insured or "Additional Named Insured" indicates the party believes it can become fully insured under the other party's CGL policy, thereby in essence obtaining third-party coverage free of charge. While the scope of additional insured endorsements may vary, a party should understand additional insured status under a CGL policy is an adequate substitute for a separate CGL policy covering the party's independent acts and omissions.

A landlord should also require that its tenants cause the landlord's property manager and its upstream and downstream affiliates to be "Additional Insureds" on tenant's CGL policies – just as it requires tenant to indemnify those parties for claims arising from accidents on the leased premises. Depending on bargaining position, the tenant may want similar provisions as a funding source of any indemnities from the property manager.

How does a party become an additional insured on another party's CGL policy? Some CG polices are structured with a broad grant of additional insured status for all persons or organizations to whom the insured is contractually obligated to name as an additional insured. Other policies require an endorsement to add a party as an additional insured. For the most part, parties that have requested additional insured status receive a certificate of insurance that purports to evidence that fact. However, a party does not become an additional insured merely by being a holder of a certificate of insurance. Just because a party is identified as a certificate holder on a certificate of insurance does not mean that it is an additional insured. Instead, a party wishing to be an additional insured must require the party maintaining the CGL policy to obtain an endorsement to its policy naming the party as an additional insured. In those instances in which the CGL policy grants additional insured status to the party as a result of the requirement in a written agreement, it is somewhat problematic to confirm the existence of the policy provision – the party would have to review the entire policy or be provided copies of the policy page granting the automatic additional insured status. An endorsement is easier to obtain and to review.

Reviewing the policy and the endorsement for provisions relating to the additional insured is important – not all additional insureds are equal. There are hundreds of different forms of additional endorsements in use. Some are standardized ISO forms; others are manuscript forms drafted by the insurance company issuing the policy. Over the last 30 years, the additional insured endorsements have been modified on a regular basis and it is fair to say the coverage afforded to an additional insured under these endorsements narrows with each iteration. Referring to ISO forms, the most commonly used additional insured endorsements naming a landlord as additional insured to a tenant's CGL policy is the CG 20 11 series; the most common endorsement issued with respect to contractors' CGL coverage is the CG 20 10 series; the most common endorsement naming a tenant as an additional insured is the CG 20 26 series; and the most common endorsement issued to a mortgagee is the CG 20 18 series.

The scope of coverage of additional insured endorsements is not uniform. For example, the form CG 20 10 04 13 endorsement (the CG 20 10 series, as revised in April 2013) used to name an additional insured for a contractor's CGL policy is not as favorable to the additional insured as the CG 20 11 04 13 endorsement naming a landlord to a tenant's CGL policy. There is no protection afforded to the additional insured against accidents not caused in whole or in part by policy owner. If the additional insured or another party has caused the accident, additional insured may not be covered.

The difference in coverage reinforces the comment above relating to the necessity of a party obtaining independent CGL coverage rather than relying on additional insured status under another party's CGL policy. There are a variety of cases dealing with the scope of coverage provided by additional insured endorsements. The outcome of these cases depends upon the wording of the endorsement issued, but from the additional insured standpoint, there are a couple of areas of general concern. First, the typical CGL policy and additional insured endorsement do not contain requirements that notice be given to the additional insured prior to cancellation or non-renewal of the policy. This means that whatever coverage is provided to the additional insured can disappear without the knowledge of the additional insured.

Second, the scope of coverage of the endorsement may or may not cover the *sole* negligence of the additional insured. It is fair to say from the perspective of the insurance company, an additional insured should not be covered for its sole negligence – if the additional insured desires this type of coverage, it should buy its own policy. Under the most recent formulations of the most common endorsements, coverage is restricted to those circumstances in which there is some negligence on the part of the purchaser of the policy or there is an attempt to restrict coverage to only those instances in which the additional insured is exposed to vicarious liability. Unfortunately, unless the endorsement is reviewed in advance, limitations in the scope of coverage may come as a surprise to the additional insured after the accident has occurred.

Third, the additional insured probably has other coverage that may cover the same event. In those instances, the additional insured may have the pleasure of observing two insurance carriers argue as to which policy should respond first to the claim. Often these controversies become hopelessly locked in circular arguments with each insurer claiming it has to respond only after the contribution of other coverage. While coverage is eventually available to the additional insured, these arguments are time consuming and generally involve additional expense on the part of the additional insured.

As a matter of drafting, it is preferable to specify in the agreement the following with respect to any additional insured coverage that is desired:

- The endorsement to be issued (preferably with a copy of the form attached) so the additional insured has some control over the scope of coverage provided by the endorsement;
- A requirement in the endorsement notice of cancellation or non-renewal be provided to the additional insured prior to the effective date;
- A requirement the coverage to be provided to the additional insured be primary and non-contributory with any other coverage available to the additional insured. See ¶ I.B.(5) above.

Accessing Broader Coverage if afforded in the policy: Parties may wish to consider language similar to the following, although parties with high limits or providing self-insurance will typically resist such inroads: "If the Lessee maintains broader coverage and/or higher limits than the minimum shown above, the Lessor requires and Lessor shall be entitled to the broader coverage and/or higher limits maintained. Any available insurance proceeds in excess of the specified minimum limits of insurance and coverage shall be available to the Lessor."

B. Contractor/Vendor Agreements. Adopting the theory employed above with respect to lease agreements that one set of requirements does not actually fit all circumstances, below are sample insurance requirements for contractors and vendors:

(1) Standard Contractors/Vendors (Low Risk Exposure) (e.g. landscaping, food vendors, snow removal, telephone equipment, appliance repair, grease trap cleaner, etc.)

(a) Workers' Compensation

- Coverage A: Statutory Benefits
- Coverage B: $1,000,000 each accident
  $1,000,000 policy limit
  $1,000,000 each employee

(b) Commercial Automobile Liability

- Owned, Hired and Non-Owned: $1,000,000 combined limit

(c) Commercial General Liability -.

- Each Occurrence: $1,000,000
- Personal & Advertising Injury: $1,000,000
- Products & Completed Operations: $2,000,000
- General Aggregate: $2,000,000

(d) Umbrella

- Each Occurrence: $2,000,000
- Personal & Advertising Injury: $2,000,000
- Products & Completed Operations: $2,000,000
- Aggregate: $2,000,000

(2) Standard Contractors/Vendors (Moderate Risk Exposure) (e.g. window replacement (2 story or less), window washer (2 story or less), interior painting, surveying, janitorial/maintenance, signage (2 story or less), moving companies, etc.)

(a) Increase Umbrella limits to $3,000,000

(3) Standard Contractors/Vendors (High Risk Exposure) (e.g. carpentry, roofers, window replacement (over 2 stories), window washers (over 2 stories, plumbing, signage (2 or more stories), awning repair/replacement, masonry/sandblasting, asphalt repair/resurface, etc.)

(a) Increase Umbrella limits to $5,000,000

(4) Contractors with Pollution Exposure (e.g. sewer work, recycling services, extermination, environmental work (asbestos, lead paint), etc.)

(a) Add Pollution Legal Liability Insurance

- Pre-Existing and New Conditions: $2,000,000 each occurrence
- Pre-Existing and New Conditions: $4,000,000 aggregate

(5) Contractors with Professional Liability/Errors & Omissions Exposure (e.g. architectural, surveying, professional consultants, property management, etc.)

(a) Add Professional Liability/Errors & Omissions

- Each Occurrence: $2,000,000
- Aggregate: $2,000,000

(6) Special note re Property Management Contracts: Management companies may have their own master program and may also want to rely on the property owner's insurance. As with leases, special care should be taken to assure that the allocation of risk and liability for loss in the management agreement is consistent with its insurance requirements. Our insurance advisors experience claims dilemmas when boilerplate agreements allocate responsibility to one party when the insurance provisions require that the other party provide insurance.

III. Coverage Issues and Claims Examples

A. Leases, management agreements, vendor contracts, construction agreements, joint venture agreements and agreements for professional services all allocate risks between the parties and typically require insurance as a source of funds when risk leads to loss. The following examples of claims and coverage issues are illustrative.

- The Property Management Contract. Property management agreements typically require the property manager to provide location liability insurance to their owner-clients, and will typically provide location insurance to the owner through a master policy administered by the management company. Problems can arise if the client insists upon being actually included in the manager's policy. In one instance, the management contract required the property manager to add the landlord to the property manager's master policy. The management agreement, however, identified landlord as the responsible party for insuring the location. As a result, the insurance adjuster denied the claim arising from the manager's conduct on the basis the property manager did not have insurable interest since the landlord was contractually responsible for insuring the location.

- Non-Owned Auto Insurance Coverage**.** A retail tenant sent its employee to the bank to make a deposit in time to make its next rent payment. When backing out of its parking space after making the deposit, the employee was also texting and hit a pedestrian. Tenant's lease did not require that it procure non-owned auto coverage; the employee's personal auto policy only provided minimum state required limits of coverage. As a result, the shopping center's general liability insurance policy had to respond for the additional damages.

- Waiver of Subrogation. Waivers of subrogation provide an almost unlimited supply of issues between landlords, tenants and their respective insurers. In one case, the lease included the following language: "Landlord and Tenant hereby mutually waive any claim against the other for any loss or damage to any of their property located on or about the Premises or the Shopping Center that is caused by or results from perils covered by property insurance carried by the respective parties, to the extent of the proceeds of such insurance actually received with respect to such loss or damage, whether or not due to the negligence of the other party." A fire occurred in the tenant's premises due to faulty wiring, resulting in substantial damage to tenant's inventory and personal property. The tenant self-insured its business personal property. Since the waiver of subrogation was limited to payments received from each party's insurer, and the tenant had no insurer, the tenant sued the landlord for damage to its personal property; under this circumstance the mutual waiver of subrogation did not shield the landlord from tenant's claim.

- Deductibles. Related to the scope of waivers of subrogation are claims arising related to the amount of deductibles and self-insured retentions maintained by the parties. See ¶ I.B.(3) above. In one case, the landlord was sued by two tenants seeking to recover damages caused by smoke damage following a fire in the building in which the tenants leased space. Because of a large deductible, one tenant had $1,000,000 in damages not reimbursed under its insurance policy and the other tenant had $530,000 of damages unreimbursed as either within the deductible amount or not covered business losses. The leases had waiver of subrogation provisions applicable to losses covered by insurance, but also allocated to the landlord the risk of damage to the tenants' property caused by the landlord's negligence. Since the deductible amounts and business losses were not covered by insurance, they were uninsured losses, the waiver of subrogation was not applicable and the landlord was responsible. See *The Gap v. Red Apple Co.,* 725 N.Y.S.2d 312 (A.D.1 Dept. 2001).

In the same vein, a claim was made against the landlord for property damage and lost profits caused by water leaks in the premises. The lease contained a waiver of subrogation clause waiving all claims "caused by or resulting from perils insured against under any insurance policy maintained by the parties." The tenant's property damage insurance was subject to an annual $750,000 deductible and a $25,000 deductible for each loss. As a result, no portion of the damage claim was covered by the tenant's first party coverage and the landlord was responsible because the amounts within the deductible were not "insured" losses. See *Hancock Fabrics, Inc. v. Alterman Real Estate I, Inc.,* 302 Ga.App. 568, 692 S.E.2d 20 (2010)

- Gross Negligence. Conduct constituting "gross negligence" is treated differently in various states. It is not uncommon to find state law provisions holding indemnification for acts of gross negligence or waivers of claims for gross negligence violate public policy and are therefore unenforceable. However, these rules can create controversies in claims involving first party (property damage) coverage and CGL policies. In a claim arising from a fire in a school, the school's insurer, as subrogee, sought to recover damages from the fire alarm company alleging the gross negligence of the alarm company negated the effect of waiver of claims clause in the service agreement. However, the waiver of subrogation clause expressly released the alarm company from all claims covered by the school's insurance, and recovery of "any proceeds paid to the school" under the property damage policy. The exculpatory clause in the agreement did not protect the alarm company from liability for gross negligence, a waiver of subrogation clause which releases and discharges an alarm company from all claims covered by insurance barred the insurer, as subrogee, from seeking return of any proceeds covered by insurance regardless of any claim of gross negligence. See *Travelers Casualty v. Global Protection Systems*, 898 N.Y.S.2d 215, 71 A.D.3d 1124 (2010).

B. Every contract, lease and agreement presents different risks, and the character and severity of risks to property and persons requires analysis to underpin appropriate insurance requirements. To paraphrase Tolstoy, every risk creates unhappiness in its own way.

C. Each agreement should clearly identify the scope of work to be performed, and which party is responsible for its performance. The scope of work should identify required outcomes and the agreement should identify consequences if those outcomes (or requirements for their performance) are not accomplished.

D. Both lawyers and their insurance advisors are trained to step back and ask key questions: What could go wrong? What are the critical steps in completing the client's objectives? Is each party qualified and are its contractor's qualified? How is qualification defined? Such questions are key to identifying risks and the management of risks and liabilities by appropriate insurance requirements.

E. A common assumption is that a contract with a low dollar value, a lease for small space, or a small scope of work carries with it a small risk of loss. Smaller contracts are not immune from larger risks.

F. Putting construction contracts aside for the moment, we will analyze the typical contractual and lease risk allocation provisions before addressing appropriate insurance coverage for typical shopping center agreements.

IV. Contractual Risk Allocation, a Summary

A. Indemnification and Hold Harmless Provisions. Insurance flows from indemnification language, and the indemnification language in a lease and its insurance requirements should be viewed together to assure that they establish a consistent risk allocation regime. Inconsistency between provisions is the enemy of an effective risk allocation.

(1) One definition of insurance in the Merriam Webster Dictionary is that insurance is "coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril." Under the theory that an insurance policy is a contract of indemnity, the insurance policy provides a source of funds under which the indemnitor compensates the indemnitee. Insurance is simply the "collateral" for the

indemnification and ensures that there are funds available to back up most of the indemnity provisions.

(2) An effective indemnification provision will contain several key elements, the extent of which will reflect the bargaining power and relative risks to the parties:

(a) an obligation to defend the other party (including employees, officers, agents, etc.); the indemnitee will want this obligation to include the requirement that it should be interpreted as broadly as possible. An obligation to indemnify or hold harmless does not necessarily include an obligation to defend. Without an explicit obligation to defend, the indemnitor may simply acknowledge the obligation and tell the indemnity to call back when the liability is established, leaving the indemnitee to bear the cost of defense, with the hope of later reimbursement. A major benefit of additional insured status is gaining the benefit of the right to defense provided in the insurance policy, even if the underlying claim ultimately proves not to be covered.

(b) depending on state law, an express agreement that the indemnification agreement includes an indemnity against the other party's own negligence. The indemnity against negligence will cause the insurance of the indemnitor to provide coverage without reference to the fault of the indemnitee; the indemnification is, however, also a risk allocation to the indemnitor, rendering the indemnitor responsible for losses not paid by insurance for whatever reason. "Hold Harmless" language allows the indemnitee to tender the claim of the damaged third party to the indemnitor.

(c) An insurance advisor will look to certain key language in a contractual indemnification provision, reflected in bold in the following example:

To the fullest extent permitted by law, Contractor shall **hold harmless, defend** at its own expense, **and indemnify [Entity]** its officers, employees, agents, and volunteers, **against any and all** liability, **claims**, losses, damages, or expenses, including reasonable attorney's fees, **arising from all acts or omissions of contractor** or its officers, **agents**, or employees in rendering services under this contract; [**including loss caused by [Entity's] negligence but**] **excluding**, however, such liability, claims, losses, damages, or <u>expenses</u> **arising from Entity's sole [gross] negligence or willful acts.**

B. <u>Additional Insured Status; the Certificate of Insurance is Not Enough</u>**.** The contract should specifically address who can be an additional insured, and typically includes the entity, its officers, employees and agents. Additional insured status gives the claimant direct rights under the other party's (typically the tenant's or vendor's) insurance. As a result, additional insured status greatly increases the claimant's chance of recovery, especially recovery of legal fees for defense.

(1) Although the two most recent rounds of changes to endorsements promulgated by the Insurance Services Office (ISO) in 2013 and 2019 limited protections for third party additional insured, including the items noted below, insurance advisors note many insureds have not updated their agreements to ensure the insurance coverage will respond as expected and, as result, open issues may remain in a claim otherwise addressed by updated endorsements.

(a) 2013 endorsements may only provide additional insured status for premises/ongoing operations liability and not for completed operations. In 2019, additional endorsements were added providing automatic additional insured status for completed and designated operations.

(b) 2013 endorsements limit coverage to what is specifically required in a contract. If there is a specific limit requirement in the contract, the additional insured endorsement will not provide coverage beyond this limit. This change was reinforced in 2019 and the language in virtually all of the additional insured endorsements provides "the most we will pay on behalf of the additional insured is the amount of insurance required by the contract or agreement." See discussion in ¶ I.B.(2) above.

(c) Entities/parties that are not specifically identified in a contract to be an additional insured will not be named as an additional insured; specificity is required.

(d) If a contract fails to identify "bodily injury" or "property damage" or "completed operations" as a requirement for coverage, coverage may not apply to these (or other) items. Attention is required to assure that all specific coverages/perils for which additional insured status is desired are clearly identified.

(2) Additional Insured Status Can be obtained under Commercial General Liability, Commercial Automobile Liability, Contractor's Pollution Liability and Umbrella / Excess Liability, but not under Workers' Compensation, Employer's Liability or Professional Liability insurance coverage.

(a) An additional insured is not added to a policy when a certificate specifies that such entity is an additional insured.

(b) The Acord Certificate of Liability Insurance contains the following relevant language in bold type: "**If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must have ADDITIONAL INSURED provisions or be endorsed."**

(c) The certificate of insurance must include a copy of the additional insured endorsement attached to the policy(ies) to verify that the proposed additional insured has been added to the policy as an additional insured for ongoing and completed operations, as applicable.

C. <u>The Relationship between Coverage, Additional Insured Status, and the Contractual Indemnity</u>.

(1) As noted above, an indemnity from a party to a contract is not the same thing as insurance coverage under the party's CGL policy. The failure to recognize this difference is given life in contract provisions requiring a party to obtain insurance for "contractual liability" and a misunderstanding what contractual liability coverage includes. CGL policies exclude coverage for losses "for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement." However, there is an exclusion to the exclusion applicable to liability for damages "assumed in a contract or agreement that is an 'insured contract'," so long as the loss "occurs subsequent to the execution of the contract or agreement." An insured contract is normally defined as:

"Insured Contract" means:

a. A contract for a lease of premises. However, that portion of the contract for a lease of premises that indemnifies any person or organization for damage by fire to premises while rented to you or temporarily occupied by you with permission of the owner is not an "insured contract."
b. A sidetrack agreement;
c. Any easement or license agreement, except in connection with construction or demolition operations on or within 50 feet of a railroad;
d. Any obligation, as required by ordinance, to indemnify a municipality, except in connection with work for a municipality;
e. An elevator maintenance agreement;
f. That part of any contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability for another party to pay "bodily injury" or "property damage" to a third person

> or organization. Tort liability means a liability that would be imposed by law in the absence of any contact or agreement.

Excluded from the scope of paragraph f are indemnity agreements relating to activity near railroads, professional service agreements for architects, engineers and surveyors. Provisions in CGL policies after 2004 normally exclude tort liability arising from the "sole negligence" of the indemnified party.

(2) Assume that the lease contains a broad tenant-indemnity such as:

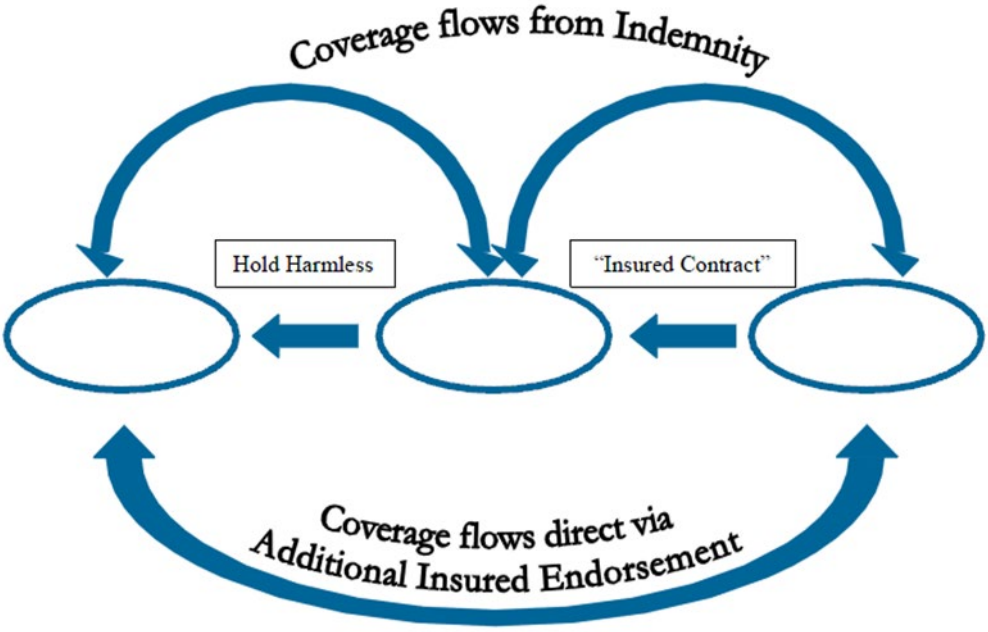
> Tenant agrees to indemnify and hold Landlord harmless from and against all liability arising from any injury or property damage occurring within the premises or arising from any claim arising from the injury of Tenant's invitees and customers within the common areas of the shopping center.

A customer trips over loose carpet while entering the tenant's store and suffers a severe broken ankle resulting in permanent injury. The customer sues the tenant and landlord, claiming both are negligent. A jury apportions liability to the injured customer equally between the landlord and tenant based on comparative negligence. After the judgment is paid, the landlord is entitled to recover the amount of its payment from the tenant pursuant to the indemnity in the lease. The issue for the tenant is whether it has insurance coverage for the obligation to pay the landlord (that is probably also the landlord's concern, since the availability of insurance provides a source of repayment). Since the lease is an "insured contract," the tenant should be able to recover the amount owed to the landlord under the tenant's CGL policy.

(3) There are, however, limitations to the indemnity coverage. The most basic is the limitation on coverage for breaches of the lease contract between the landlord and tenant. Assume the same lease obligated the tenant to maintain and repair the HVAC system providing service to the premises. A dust storm causes damage to the HVAC system and the tenant fails to pay for the repair. This is a breach of the lease and the tenant has assumed the liability for repair. However, this situation does not involve the assumption of any liability owed by the landlord; the fact the landlord has suffered property damage does not mean the landlord has incurred liability to a third party assumed by the tenant and the fact the tenant has agreed to repair the HVAC system is not an assumption of a liability owed by the landlord. In analyzing this second example, it is useful to remember indemnity agreements involve three parties – the indemnitor, the indemnitee and the third party that has suffered injury or damage. The failure of the tenant to perform its repair obligations under the lease involves only two parties – the landlord and the tenant. The failure to perform this obligation, even though the tenant has "indemnified" the landlord against loss from breach of the lease, does not involve an obligation in which the tenant has assumed a liability owed by the landlord to another and is therefore not covered by the CGL policy. The repair scenario also highlights the coverage provided under the CGL policy is also subject to all of the other exclusions to the policy, including the exclusion for damages to property owned or rented by the insured. Similar exclusions for mold, terrorist activities and certain other special risks (such as dram shop liability or garage keepers liability) are excluded from coverage in the typical CGL policy. The "contractual liability" provided with respect to an insured contract does not expand the risks covered by insurer issuing the CGL policy.

(4) The primary risk associated with indemnities between parties to an agreement is that the scope of the indemnity will exceed the insurance available to the indemnitor either because the damages exceed policy limits or because the risk giving rise to the indemnity is not covered by the indemnitor's insurance policy. The same risk is present for the indemnitee - without a source of funding for the indemnity obligation, the value of the undertaking to the indemnitee is also doubtful.

(5) As noted, insurance coverage follows the contractual indemnity, and additional insured status is granted under an additional insured endorsement, as illustrated by the following graphic:



D. Waiver of Subrogation: "Subrogation", the equitable assumption by a third party (typically an insurance company) of another party's legal right to collect a debt, occurs when an insurer pays a claim; upon this payment, any rights the insured may have to recover all or part of the payment from the party (or its insurer) responsible for the loss are transferred to the insurer. The right of subrogation is typically waived in a lease or other agreement to minimize litigation and cross-claims between insurers and avoid unnecessary conflicts between parties to an agreement over losses otherwise covered by insurance.

(1) The waiver of subrogation is typically a mutual waiver, but at times is a one-way waiver, and serves to waive the right of one party's insurance company to seek reimbursement from the other party and the other party's insurance company. The Acord Certificate of Liability Insurance specifically states "If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must have ADDITIONAL INSURED provisions or be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. ***A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).***" [emphasis added]

(2) The waiver of subrogation can vary. The waiver of subrogation can be of all claims (including the deductible and excess amounts). The waiver of subrogation can be self-operative. At times the waiver of subrogation can require specific insurance clauses. As discussed above, specifically dealing with whether amounts within deductibles and self-insured retentions can avoid unpleasant surprises as to the applicability of the waiver.

(3) Most leases limit waivers of subrogation to losses covered by property insurance, but waivers of subrogation may also include other insured losses, including those covered by commercial general liability policies and automobile policies.

(4) The right to waive subrogation rests with the insured and requires action on the insured's part by way of written consent prior to a loss – "Tenant shall waive, and shall cause its insurers to waive, any rights of subrogation as respects claims covered, or which should have been covered, by valid and collectible insurance…"

(5) In instances where one party to an agreement can suffer a loss that is disproportionate to the potential loss of the other party, the party with the most at stake may insist on a one-way waiver under which it does not itself waive the right to subrogate.

E. Exculpation: An exculpation clause is a contractual provision under which the "waiving party" agrees to release the "exculpated party" from liability for loss arising from the exculpated party's fault and/or for which the exculpated party would normally be financially responsible is typically referred to as an exculpatory clause. The waiving party is, under the exculpatory clause, relinquishing its right to seek recovery for loss from the exculpated party.

V. The Houdini Dilemma and the Certificate of Insurance.

A. The Anatomy of the Certificate: Parties often rely on certificates of insurance to confirm that required insurance is in place. Requirements to provide copies of a declaration page (even redacted) can be received with rejection and disbelief. An understanding of the limitations and anatomy of the Certificate of Insurance is therefore critical. The following discussion tracks the sample (blank) certificate of insurance on the following page:

Item 1 – This block identifies the Agent or Broker that wrote the insurance policies for the insured, and is required information for reporting of a claim.

Item 2 – The sample certificate confirms the provisions of the California Insurance Code, §384 and states that the policy, not the certificate, governs coverage. Other states have similar provisions. As a result, this language provides a warning that the Certificate cannot be relied upon.

Item 3 – Block 3 identifies the insurance underwriter. The insurer letter appears again near the left margin at 3a to show which insurer provides which coverage.

Item 4 – The name of the insured, to be stated here, contains the name of the person or entity for whom the insurance policy is written, and the name entered in this field must match the contractor, landlord, tenant, or other party named in the applicable lease or other agreement that is required to provide insurance.

Item 5 – Another warning; the notice again states that the policy supersedes the information in the certificate.

Item 6 – These sections identify the applicable insurance coverage and will identify insurance procured only by the named insurance brokers. If the insured uses more than one insurance broker, this certificate must be supplemented by other certificates from such other brokers. Claims made forms are not typically acceptable, and liability insurance should generally be written on an occurrence basis. As previously discussed the general aggregate limit should apply "per project" or "per location" if there are more than one project or one location covered by the policy.

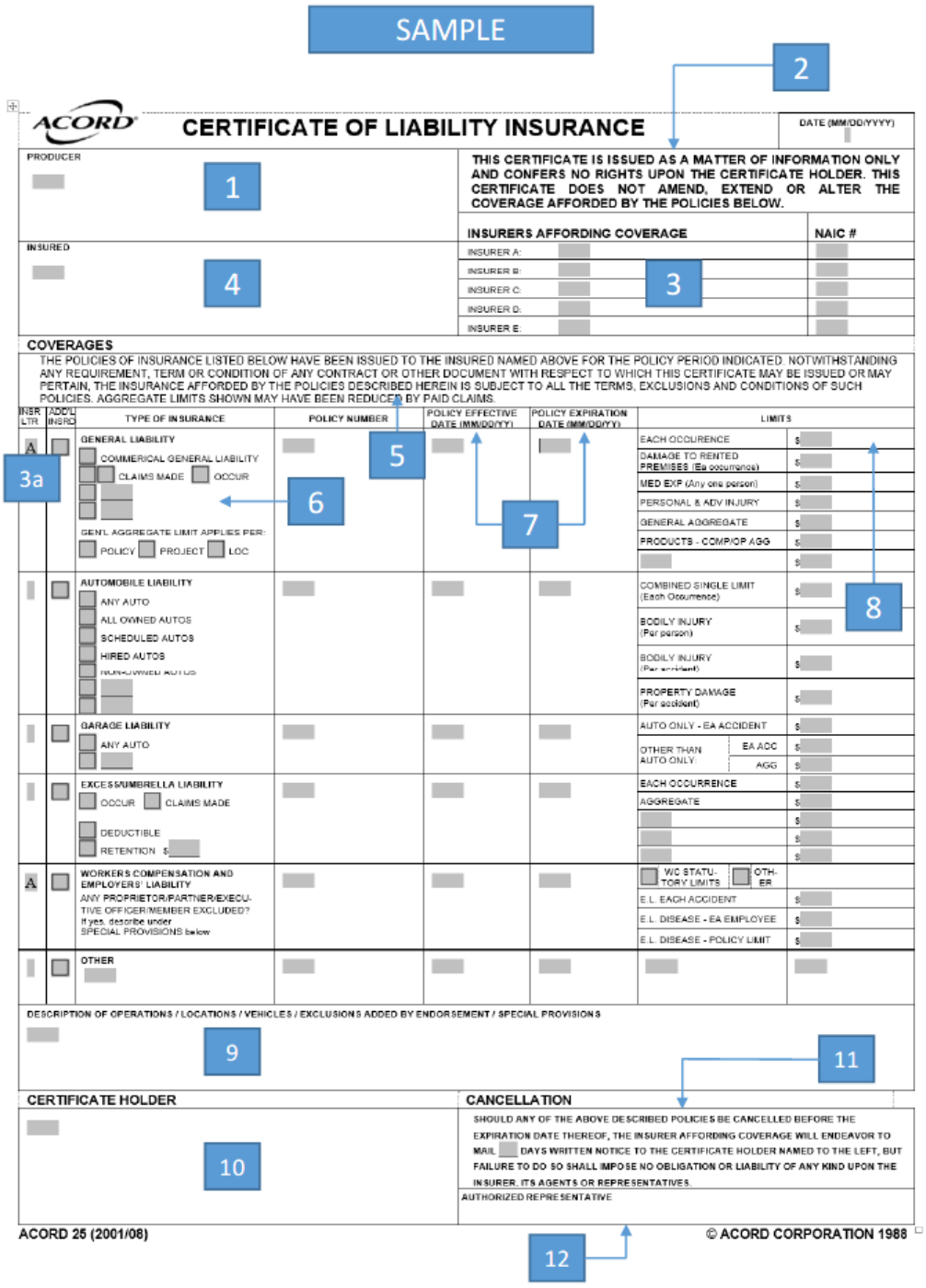
Item 7 – These two columns show inception and expiration dates for policies identified; updated certificates should be provided by the contracted entity prior to any expiration date.

Item 8 – This column identifies limits per occurrence and aggregate for each type of coverage Losses on other jobs or locations may reduce General Liability coverage, unless the aggregate limit applies "per project" or "per location".

Item 9 – This section will usually be used to restrict coverage to a specific job or lease. Special descriptions and requirements are included such as site codes, locations codes, additional insureds, waiver of subrogation, notice of cancellation, etc. Restrictions that would omit required coverage may be included.

Item 10 – The Certificate Holder box reflects the name and mailing address of the certificate holder. No rights, privileges or insurance coverages are extended to a certificate holder, unless specifically the certificate specifically states "Certificate Holder is an additional insured".

Item 11 – The cancellation provision outlines the terms for providing notice about policy cancellation. Agreements typically require a minimum of 30 days' written notice of a policy cancellation, except the typical notice period is 10 days if cancellation is for non-payment of premium.



B. Issues with Certificates. The primary problem with certificates of insurance is the disclaimer language contained in the box in the upper righthand corner:

> **THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.**

This language means exactly what it says and there are a significant number of court decisions holding certificate holders are not entitled to rely on information in the certificate conflicting with the actual policy, such as who is an additional insured, policy limits, scope of coverage or the existence of the actual policy. See for example, *T.H.E. Insurance Co. v. Naghtin,* 916 F.2d 1082 (6th Cir. 1990); but *c.f. T-Mobile USA, Inc., v. Selective Insurance Co. of America*, 194 Wn.2d 413, 450 P.3d 150, 2019 Wash, Lexis 659 (2019). The insurance industry has also enlisted the aid of various state regulators to pass statutes or adopt rules specifically providing the contents of certificates issued by agents or producers cannot amend or alter the terms of the policy. The existence of state regulations concerning the modification of policies is a good reminder that attempts to alter coverage cannot be accomplished by modifying a certificate of insurance; only the actual policy controls what coverage is provided. That being said, common practice is to rely on issued certificates and in the vast majority of transactions, issuing the certificate will be the only evidence of insurance provided to demonstrate compliance with contractual insurance requirements. Whether this is sufficient is dependent upon the importance of the specific coverage negotiated to the overall transaction. If the coverage is absolutely essential, the parties may wish to consider additional documentation.