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General Session 3

DRAFTING INSURANCE LANGUAGE: HOW TO DRAFT TO TRIGGER THE APPROPRIATE COVERAGE, NOT COMMIT MALPRACTICE

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Introduction

Many things have changed in insurance and risk management in the last 30 years, including policy terms and language, the availability of coverages, and the exploding size of judgments and settlements. But lease and other contract insurance provisions still use 30-year-old language, leave out coverages and protections, and require completely inadequate limits. Worse, most leases and other real estate-related contracts are not aligned with the parties' insurance contracts, creating gaps and uninsured balance sheet risks – the contracting parties forget that their insurance contracts are the silent parties to their agreements.

In this program, the panelists, including two insurance industry experts, will tell you what property and liability coverages are available and needed today and why some older contract language may actually impair access to the available coverages.

In these materials, we will refer to forms promulgated by the ISO (the Insurance Services Office), which is an organization that serves the insurance industry. Other forms are often used, and for sophisticated insured parties, many of the forms in the coverage package will be "manuscript" or non-standard coverage documents. But most of the forms in use today, including the manuscript forms, rely on ISO language for their provisions. ISO forms are designated by letters and numbers indicating the type of form and its year: for example, ISO's current direct damage to commercial property form is CP 00 10 10 12. The last two sets of numbers indicates the form's year – in the example, the form was promulgated in October 2012. New editions seldom increase coverage – more often, they limit coverage to assist the insurance providers.

Let's start with an explanation of the basic types of insurance your lease or contract should require and the changed concepts and language needed to give your client the benefits of this coverage.

A. Liability Insurance:

1. *The Basics.*

- Liability Insurance is maintained to cover the defense costs of and liability for third-party accidents on leased premises or other property. Liability policies state, "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage,' to which this insurance applies. We will have the right and duty to defend the insured against any 'suit' seeking those damages."

    - *Liability policies cover defense costs and, up to the coverage limits, provide liability protection.*

- All parties should maintain their own liability coverage, and in a Lease, the Landlord should require the Tenant to carry specified coverage.

    - *Don't call this "Casualty Insurance." Lawyers think "Casualty Insurance" means Property Insurance, and insurance professionals think "Casualty Insurance" means Liability Insurance. Call it Liability Insurance, which is what it is.*

    - *Replace the references to "personal injury" with "bodily injury" in both your insurance requirements and your indemnity provisions. Then add a requirement that "personal injury" be covered also, along with property damage. Liability policies refer to physical injury to a person as "bodily injury," not "personal injury." Personal injury is advertising injury and things other than physical injury to a person.*

- "Commercial General Liability Insurance" ("CGL") has been the customary form for many years.

    - *Don't require or let your client agree to maintain "Public Liability Insurance" or "Comprehensive General Liability Insurance." They haven't been around for years.*

- The standard CGL Policy includes an exclusion of contractual liability coverage, but as an exception to this exclusion, it covers some of a Tenant's bodily injury and property damage indemnities in a Lease –

though indemnified defense costs will erode the limits.

- *Landlords should be sure to include a requirement that the Tenant pay defense costs as part of their indemnity language -- Tenant's insurer won't pay these defense costs unless indemnity for them is specifically required.*

- *Only limited coverage is provided by this contractual liability provision – it's much better for the Landlord to be an Additional Insured, and even better for it to have its own liability coverage in light of the gaps in the Additional Insured and contractual liability coverage.*

2. *What Liability Insurance Should a Landlord Require the Tenant to Carry in a Lease?*

- Before drafting the required types and limits of liability coverage, the Landlord and its lawyer should consider the location and type of risk, the Tenant's use, and the amount of coverage needed considering this location and use.

- In addition to the basic CGL coverages, Landlords should require or consider requiring their Tenants to maintain:

(a) Commercial Automobile Liability –Owned, Hired and Non-Owned: Provides bodily injury and property damage coverage for liability arising from an automobile accident or other vehicle damage.

(b) Non-Owned Auto Insurance: Provides a source of funds for loss and damage occasioned, for example, by an accident caused by a Tenant's employee or principal while using his or her personal vehicle on the premises or outside the premises, for example, in the common areas of a shopping center.

(c) Liquor liability insurance coverage: Most states require establishments that serve alcoholic beverages to carry liquor liability insurance. Whether or not the beverages are served in a jurisdiction requiring such insurance, this coverage should be required in any lease or license as a condition of the insured Tenant's or licensee's service of alcoholic beverages.

(d) Workers' compensation insurance: Workers' compensation insurance is required by statute in most jurisdictions, although these requirements may not apply to small businesses. This insurance provides compensation for medical expenses and lost wages due to an employee's work-related injury. If state law permits the underwriter to waive its rights of subrogation, then the Landlord or in the case of a construction contract, owner, should require its Tenant or contractor to have its workers' compensation policy endorsed to waive the underwriter's rights of subrogation. A CGL policy will typically contain an exclusion for claims covered by workers' compensation insurance, so this waiver is needed to protect the Landlord from liability.

(e) Employer's liability insurance: A second typical CGL exclusion is for claims that would be covered by a policy of employer's liability insurance. This type of 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. Again, the Landlord should require that the policy include an endorsement in which the insurer waives rights of subrogation as to the Landlord.

(f) Pollution: Although not frequently considered in the retail context, Tenants that will engage in operations posing an environmental risk should be required to have pollution/environmental liability insurance. For example, a business that sells chemicals, paints and solvents, a gas station, a laundry, and big box and hardware stores will typically raise pollution risks. In addition, a location's heavy sanitation requirements will increase environmental risk, as will an operational need to use and dispose of environmentally sensitive materials, including medical materials and medical waste. Coverage for mold or Legionnaire's is a pollution exposure. Maintenance of this coverage should be required for at least two years after termination of the lease (and possibly more) if it's written as a claims-made policy. The Landlord should also require that it be an additional insured on this policy.

(g) Specialty insurance in general: The proposed Tenant or contractor's construction, renovation, and operation of a location should all be considered in determining the Landlord's or owner's requirements for specialty insurance. For example, a Landlord should consider requiring specialty insurance for jewelry, art work, special events and entertainment, and certain construction activities such as the use of cranes, because property and liability policies generally exclude coverage for these items and activities. While the requirement for specialty liability insurance is often an afterthought, the risks and costs that would otherwise be without coverage can be substantial.

(h) Umbrella Insurance. This very important coverage provides excess coverage above the limits of the insured's listed underlying liability coverages for, by way of example, general liability, automobile and employer's liability.

3. *What Limits of Liability Insurance Should a Landlord Require the Tenant to Carry?*

- Settlements and verdicts have increased exponentially over the years, and lease and contract required limits must increase also.

  - *Increase the initial limits – you can state that the greater limits can be provided by a combination of primary coverage and umbrella or excess coverage.*

  - *Add a right by the Landlord to increase the limits from time to time, perhaps stipulating the number of years after which an increase can be required and stipulating a percentage limit to the amount of each increase.*

- For almost 30 years, insurance limits have not been expressed as "$_____ for bodily injury, $_____ for property damage, and $_____ for completed operations." Instead, CGL insurance limits are now expressed as being per occurrence, with two different annual aggregates.

  - *Require $_____ per occurrence, and $_____ in the aggregate.*

- 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 for products-completed operations matters and a separate limit that caps only product-completed operations claim amounts.

  - *Require that the tenant's or other contracting party's coverage be on an occurrence basis, not a claims-made basis.*

- By reason of limitations in Additional Insured endorsements, the Landlord or other party seeking to benefit from another's liability insurance should require the highest limits the other party will agree to and specify that the required limits are "minimum" limits or that the limits can "not be less than" to avoid triggering this limitation.

4. *Current Additional Insured Issues.*

- 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." The only way a Landlord or Owner can receive 1st party benefits from a Tenant's or Contractor's Liability Policy is as an "Additional Insured" – this is a crucial requirement for the Landlord or Owner.

  - *No, the Landlord or Owner can't be a "named insured" on another entity's coverage – only the entity carrying the coverage and its affiliates can be "named insureds."*

  - *No, don't ask to be a co-insured – co-insurance is a penalty imposed on underinsured property in property insurance policies.*

- There are many different forms of additional insured endorsements in use. Some are standardized ISO forms (ISO CG 20 11); others are manuscript forms drafted by the insurance company issuing the policy. Over the last 30 years, the ISO additional insured endorsements have been modified on a regular basis, and the coverage afforded to an additional insured under these endorsements has narrowed with

each iteration.

- The ISO 2013 Additional Insured form designed for Landlords and Managers as additional insureds (ISO CG 20 11 04 13) was commonly used for a number of years. It provided the coverage most Landlords expect in that it covered the additional insured for "liability arising out of the ownership, maintenance or use of that part of the premises leased to [the insured]."

- In 2019, a new endorsement for Landlords and Managers was promulgated: ISO CG 20 11 12 19. This form significantly narrowed the Landlord's protection provided by being an additional insured on a Tenant's liability policy: it covers the additional insured Landlord only for liability "caused in whole or in part by the [Tenant] or those on the [Tenant's] behalf" in connection with the ownership, maintenance, or use of the part of the property that is actually leased to the insured." This endorsement requires that the Landlord show that the accident was caused, at least in part, by the Tenant or someone acting on its behalf.

    - *In a Landlord's Lease, require that the Tenant provide the Additional Insured coverage through an ISO CG 20 11 04 13 form of endorsement or its equivalent – but check the endorsement to be sure it really is equivalent to an ISO CG 20 11 04 13 and doesn't limit the coverage to accidents caused by the Tenant or someone acting on its behalf – this new language excludes additional insured coverage for accidents caused solely by the Landlord or another third party.*

- Both of the endorsements, the 2013 and the 2019 versions, (i) cover only accidents that arise out of the Tenant's use of the Premises itself, arguably omitting coverage for accidents that occur elsewhere, for example, on a loading dock, and (ii) provide that the coverage provided is no broader than the coverage that the Tenant is required to provide in the Lease – including the amount of required coverage.

    - *For the Landlord, be sure to specifically state that the amount of coverage required is a minimum amount or not to be less than the specified amount, and that if the Tenant carries greater limits of liability insurance, the Tenant is required to name Landlord as an additional insured for these greater limits.*

    - *For the Landlord, include a broad indemnity from the Tenant.*

    - *To make sure that the Tenant's liability insurance always pays first for covered liability, even if the Landlord is also carrying liability insurance, in the Lease, the Landlord should require that Tenant's policy be endorsed to provide that its coverage is "primary and non-contributing" with respect to the additional insured Landlord.*

5. *The Need for Landlord to Carry its own Liability Insurance.*

- <u>In light of the gaps in liability coverage provided to an additional insured, a Landlord should carry its own liability coverage</u>, rather than relying solely on being an additional insured on the Tenant's policy, but whose insurance is primary? Landlords clearly want the Tenant's additional insured coverage to be the first to cover any claim, with the objective of having the Landlord's coverage apply only after the Tenant's has been exhausted.

- Lease agreements, services contracts, and other agreements should clarify which party's insurance is required to be primary based on, for example, whether the loss occurs in common areas or in a Tenant's premises and based on the allocation of responsibilities in the indemnity provisions, but to make this effective as to accidents in the premises, Tenant's policy must include an endorsement stating that the policy and the additional insured coverage under it is primary and non-contributory.

    - *To make sure that the Tenant's liability insurance always pays first for covered liability, in the Lease, the Landlord must require that Tenant's policy be endorsed to provide that its coverage is "primary and non-contributing" with respect to the Additional Insured.*

    - *If Landlord is going to contractually indemnify tenant and pay defense costs for accidents that occur in common areas maintained by Landlord, they should also consider naming the tenant as additional insured (to the extent that the Landlord can get this endorsement for its policy). This will trigger defense costs for the tenant within their policy, avoiding litigation over whether defense costs are covered.*

B. Property Insurance:

1. *The Basics*.

- Property Insurance is maintained to pay the insured party the actual cash value (this is the depreciated value) or the replacement cost of property, probably a building or other improvements, that is destroyed or damaged by fire or other casualty. In a Lease, the parties should allocate between themselves the duty to insure the leased property, and the Landlord should expressly require the Tenant to insure its own property (or to waive all claims against Landlord for loss or damage to that property) as well as all Tenant Improvements.

    - *Don't call this "Casualty Insurance." An insurance professional will think you're requiring Liability Insurance. Call it Property Insurance, which is what it is.*

- A wise property owner should insure its own property for a few reasons: (1) the owner will be the named insured with the right to deal directly with the insurer rather than a loss payee or additional insured, (2) the owner will know that the policy is in effect and whether it has been modified or terminated (it won't need notice of termination or modification from the Tenant's insurer – notice that insurers don't like to send to owners), and (3) the owner need not obtain a copy of and review the policy carried by the tenant or other contracting party to be sure that it satisfies the lease or contract – and the requirements of the owner's lender.

2. *Landlord Contract Necessities if the Leased Property is Insured by a Net Tenant*.

- As lease lawyers know, in Net Leases with large national Tenants, the Tenants insist on carrying the property insurance coverage on the Leased Property. What can the Landlord put in the Lease to protect itself?

- Require full Replacement Cost Coverage (rather than Actual Cash Value, which is the depreciated value).

- Require the Tenant to maintain a "Special Causes of Loss" form property insurance policy, rather than the much narrower "Basic Form" or "Broad Form."

    - *Don't require an "All Risk" or "Broad Form" policy. "All Risk" has not existed for many years (except in Builder's Risk), and "Broad Form" is not broad.*

    - *Watch the Covered Causes of Loss*

- Require Flood coverage to the limits of NFIP coverage and if desired, additional coverage from private insurer.

    - *The NFIP requires reauthorization by Congress regularly for new NFIP policies to be issued. When these materials were prepared, the NFIP was to lapse unless reauthorized by September 30, 2024.*

- Require the Tenant to name Landlord and its mortgagee as "loss payees" and "additional insureds." If the policy will also cover Tenant's improvements that Tenant will own, this can be "as its interests may appear."

    - *Tenant will be the "named insured." All Landlord can be is a "loss payee" or "additional insured."*

    - *If the Tenant won't make Landlord a loss payee (and many national Tenants will not), at least be sure that the Landlord will be an "additional insured as its interests may appear."*

- Require an "Agreed Value" coverage endorsement to avoid the application of the co-insurance penalty (reduces the coverage exponentially). Annual appraisals may be required.

- Require a low deductible with Lease language assuring that Tenant must pay it.

- Resist blanket policies. Avoid self-insurance.

- *Self-insurance is no insurance. If you must, then outline that coverage must apply as if specific ISO property and liability policy forms or their equivalent were in place. This will help establish a baseline of how the tenant's self-insurance should respond.*

- Require the Tenant to continue to pay rent after the damage – no rent abatement. If the rent doesn't abate, the Tenant's business income coverage should cover the rent.

  - *Loss of rents coverage can generally be maintained only as part of a property insurance policy, so the Landlord cannot maintain it if the Tenant is insuring the property.*

- If the Tenant is carrying the property coverage, then (i) if the Landlord is required to restore after casualty, Landlord should require that the proceeds be provided to Landlord before it's required to start restoration, and (ii) if the Tenant is to restore, the Landlord should require that the proceeds be escrowed for that work. As proof of insurance, require not only an ACORD Evidence of Insurance, but also a copy of the policy on request.

3. *Waiver of Subrogation: A Necessary for Both Parties.*

- It does little good to allocate the property loss risks in a Lease unless the insuring party protects the other party from a claim of subrogation by the insuring party's insurer (if the insured property is damaged by the negligence of a party that's not the insured, the insurance company can exercise its subrogation rights by suing the party that caused the damage to recover the amount paid). This protection can be provided by a waiver in the Lease by the insuring party of its right to make claims against the other party for loss of or damage to the insuring party's property.

- In a Lease in which the Landlord is insuring the leased property, the Tenant should require the Landlord to waive its claims for damage to or loss of the leased property to the extent that it is or would have been insured by a "special form" property policy, and it should require the Landlord to obtain a waiver of subrogation endorsement by its property insurer. If the Tenant is insuring the leased property, the Landlord should not waive claims for loss of or damage to that property.

- In all Leases, the Landlord should also require the Tenant to waive its claims for damage to or loss of the Tenant's own property and should require the Tenant to obtain a waiver of subrogation endorsement in the Landlord's favor in all of its property policies.

4. *Loss of Business Income/Loss of Rents Insurance: The Most Misunderstood Property Coverage.*

- Loss of Business Income coverage is the part of a business's overall property insurance policy that provides the funds to replace the business profits lost during a period of restoration after an insured event when the insured is not able to operate or operates at a reduced capacity.

  - *Business Income Coverage is certainly wise for all businesses that carry property coverage and that rely on real or personal property in their operations.*

  - *A Tenant's Loss of Business Income insurance will also cover its "continuing normal operating expenses." If the Tenant's rent does not abate upon casualty damage, these "continuing normal operating expenses" will include the rent that continues to accrue while the premises are being restored.*

  - *Landlords often require the Tenant to maintain Loss of Business Income coverage to provide income that permits the Tenant to continue operations – but if the rent abates upon casualty, Tenant's Loss of Business Income policy will not cover the Tenant's rent since that rent will not be due after the casualty.*

  - *Particularly if the Tenant is insuring Landlord's premises, to preserve coverage of Landlord's rent under Tenant's Loss of Business Income policy, the rent should not abate, and the Landlord should require the Tenant to maintain Loss of Business Income coverage that insures "continuing normal operating expenses."*

- Loss of Rental Value coverage is the part of the Landlord's property insurance policy that covers the rental loss that the Landlord suffers while the damaged property is being restored.

    - *A Landlord that insures the leased premises should maintain this coverage as part of its property policy, but for the Landlord to receive payments from the insurer under this coverage, the rent must abate during casualty restoration.*

    - *If the Landlord is insuring the leased premises, it's best for the Landlord to abate the rents upon casualty damage and recover the lost rents from its own Loss of Rental Value coverage.*

C. Additional Things to Consider:

1. *Proof of Insurance*.

- In most leases, the parties require the delivery of certificates of insurance with respect to liability insurance and evidence of insurance with respect to property coverage. The commonly used forms for these certificates or evidence are promulgated by ACORD (the Association for Cooperative Operations Research and Development), another company that serves the insurance industry by, among other things, developing standard forms for the underwriters.

    - *These underwriters do not want to be bound by a one-page form filled out by a broker or clerk, so they've made them unreliable.*

- The one-page ACORD certificates and evidence of insurance are actually not proof or evidence of anything; in fact, they state on their face that they are not binding on the insurer. The insurers take the position that a one-page form cannot override a policy comprising pages and pages of coverages and limitations on coverages. W. Rodney Clement Jr., Is a Certificate of Insurance a Worthless Document?, 24 PROB. & PROP. 46 (May/June 2010). These forms no longer even say that the insurer will give – or endeavor to give – the certificate holder notice of coverage cancellation.

    - *If the certificate holder wants notice of cancellation or material modification, it needs to obtain an endorsement to the insured's policy in which the insurer commits to give this notice.*

    - *A certificate holder is not automatically a loss payee or additional insured; the party that wishes assurance that it is a loss payee or additional insured needs to obtain a copy of the actual endorsement.*

- A party that is relying on another party's insurance can protect itself by requiring the insuring party to provide, from time to time, and in addition to a certificate or evidence of insurance, a certified copy of the policy itself, or at least the declarations page, the schedule of forms and endorsements comprising the policy, and all endorsements that are needed to provide the required coverage. The party relying on the coverage must then review the policy or other information provided to assure that the documents provide the required coverage and do not contain endorsements that diminish that coverage. Many times the party requesting the proof of coverage may have to compromise by accepting a redacted copy of the policy, with locations not associated with the Lease removed, in lieu of a certified copy.

- Many large Tenants now tell the Landlord that if a Lease requires that the Landlord be an additional insured or loss payee under the Tenant's liability or property damage policy, or that a waiver of subrogation be provided on the Tenant's policies, then the Landlord doesn't need an endorsement because it will automatically be the loss payee or additional insured or a waiver subrogation by reason of the contractual requirement. But how can the Landlord confirm that these automatic provisions are in the Landlord's policy?

    - *If the Landlord does not require a separate endorsement, the Landlord will have to review the entire policy to ascertain the accuracy of what the Landlord's real estate representative has said (and the exclusions in the policy language). It's far easier to require and obtain an endorsement in which the Landlord is expressly made a loss payee or additional insured under the required coverage terms.*

2. *Deductible vs. Self-Insured Retention*.

- While both a deductible and a self-insured retention in a liability policy represent a portion of a risk allocated to the insured and for which the insurance policy will provide no source of payment, the contractual responsibility of the insurance company is different for each.

- With a deductible, the insurer is responsible for the claim even if the deductible is not collected from the insured. In other words, the insurer will cover the deductible amount in its payments to a third party making a claim, but then collect the deductible from the insured.

- In contrast, a self-insured retention is effectively no insurance - the insurer is not responsible for payment of any loss until the insured has satisfied the self-insured retention. In this case, if there are concerns about the insured's ability to cover retention amounts, the party that will receive the benefit of the insured's coverage may require the insured to cover the self-insured retentions under a separate policy with no self-insured retention.

3. *Per-Location Aggregate Limit*.

- If the insured (generally, in leases, the insured Tenant) operates at multiple locations, then the Landlord should require a per-location aggregate limit of insurance on Tenant's general liability and liquor liability insurance. The per-location aggregate limit prevents the insured's overall limits of coverage from being diluted by the number of locations it operates.

- 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 there is no per-location aggregate limit, a large loss and claim at one location could exhaust coverage otherwise available at the Landlord's or Owner's property location.