

Not My Problem – Or Is It?

Insurance Considerations in Leasing Arrangements

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Insurance for landlords and tenants, is a matter that typically may be glossed over in the negotiation of a lease. It shouldn't be. Proper insurance coverage can soften the blow and save your company from insolvency. A major loss from fire, vandalism or other causes can be devastating.

Even in "routine" commercial leasing arrangements, both parties need to review the lease to ensure there are no gaps in insurance coverage. An analysis of a party's own risks sought to be insured, and also to an extent, the risks faced by the other party or parties to a lease will identify the gaps.

This article presents some of the issues for consideration by landlords and tenants with respect to insurance coverage.

The insuring party—The complex issues of insurance are multiplied by the addition of other parties such as tenants or the lessor property owner. Each party will have opposing viewpoints on whose responsibility it should be to pay for coverage. In any event, the most important thing is that somebody obtain the necessary coverage!

Coverage limits—Both parties in a leasing relationship have an interest in ensuring that adequate insurance coverage limits are in place. This topic is best addressed in a discussion with an insurance professional regarding the nature of the parties and their businesses. Landlords should consider "excess" insurance for additional protection beyond the coverage required by tenants for their own protection.

Review standard forms—As in any situation where one party demands the use of its standard form, the form should be reviewed for its implications. An attractive rent for a tenant may not be as attractive if comprehensive, high limit insurance coverage of all conceivable risks is required to be obtained by the tenant.

Proof of Insurance—For landlords, a requirement for prospective tenants to demonstrate adequate insurance by way of an insurer's certificate, is a good idea. This requirement is a standard practice with banks and other lenders for good reason. A tenant with inadequate insurance puts more parties than just themselves at risk.

Exclusions—material risks—Policies of insurance require disclosure from an insured party of the risks that it seeks to insure. This is especially important at the time of obtaining insurance, but is also an ongoing consideration that requires diligence and good

faith. Where either a landlord or tenant have doubts about whether a change in the business, the premises or other factors constitute a “material change”, they should err on the side of caution and report the same to their insurer. This will go a long way to avoiding a denial of coverage following an accident or other claimable event.

Indemnification and waiver of subrogation—“Subrogation” is the right of an insurer after having paid out a claim to seek reimbursement of its payout from the party that caused the loss. Without an agreement in place regarding waiver of this right, undesirable results can occur in a leasing arrangement whereby the non-insuring party is sued by the insurer “on behalf” of the insured party.

The role of a broker/ consultant—A good business relationship with a broker or insurance consultant can go a long way to eliminate many of these issues and to minimize risks without the need to become an expert in the interpretation of insurance coverage and exclusions.

There are many situations that illustrate the required considerations. The following are a few examples of the clauses and terms in practice:

1. *A small business leases a portion of its space to another related business owned by a friend to share some overhead costs. The terms of the lease are limited to price, length of the lease, and certain discounts for each other’s products. Shortly after moving in, the tenant’s business products are the source of a fire that destroys the entire building. The tenant did not have insurance, although the landlord did. The landlord did not advise his insurer of the new tenant.*

This first example illustrates a few of the most basic considerations. From the landlord’s perspective, material changes such as allowing a business tenant into the premises must be communicated to the landlord’s insurer to confirm continued coverage. It is quite possible that the landlord’s insurer would deny coverage in this circumstance where the new tenant’s products were the source of the fire. From the tenant’s perspective, whether or not to obtain insurance coverage is a business risk that involves more than merely replacement cost of products; in this circumstance the tenant’s exposure to liability greatly exceeds that of the products that were destroyed.

2. *A fire destroys a strip mall, where the tenants are required to insure their premises and the landlord insures the building. The investigation that follows determines the cause to be faulty wiring in the building. The tenants’ insurers pay out their claims, then sue the landlord and the contractor in the name of the tenants for the loss.*

Subrogation is the right of an insurer to “step into the shoes” of the party insured and sue the party or parties that have caused the loss that the insurer paid. To avoid this situation, a “waiver of subrogation” and an indemnification clause is required between the landlord and tenant.

3. *The landlord specifically requires the tenant to insure its premises. The tenant takes out the policy. A very large occupier’s liability claim is made against the tenant which exceeds the limits of the tenant’s policy. The tenant is now insolvent.*

Where both parties have an interest in insuring against certain risks, merely ensuring that a party has the appropriate insurance may not be enough. “Excess Insurance” is a type of coverage where a policy is obtained (in this case, by the landlord) to insure against potential claims that exceed the policy limits of its tenants. Where a party requires the other to obtain insurance, specifics of the policy and limits should be included.

In conclusion, the following are some important considerations for effective insurance coverage:

- Consider the risks facing your business (as a landlord or tenant). Is there coverage in place for these risks?;
- Determine what the exclusions are on your policy so that you can make an informed decision as to whether to have these exclusions waived (with a likely increase in premium);
- Ensure that it is clear between the landlord and tenant which party is obtaining insurance coverage;
- Check for indemnification clauses and waiver of subrogation; and
- Finally, develop a good business relationship with your broker or insurance consultant and ensure that they have received and reviewed your lease.

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