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"Hot Points" - Insurance Clauses Found in a Commercial Lease

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"HOT POINTS" INSURANCE CLAUSES FOUND IN A COMMERCIAL LEASE

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There are many quirky phrases found in a typical commercial lease that often confound the reader. Some of them are addressed in Catherine Dowdall's and Stuart LeMesurier's comments in this paper. I will try to explain briefly a few of the classics:

- **Named Insured**

  A named insured "owns" the policy and therefore has:

  (i) The right to sue the insurance company in its own name for payment of claims.

  (ii) The right to insist that the policy not be amended without its consent.

  (iii) The right to negotiate with the adjuster when a claim is processed.

  (iv) The right to be named in the insurance company's cheque in settlement or payment of a claim.

  A named insured has a great deal of control over the administration of the policy. Landlords often require Tenants to have their insurance policies "name" the Landlord (and/or the Mortgagee) as an insured party. This basically provides the Landlord with an extra insurance policy which it did not place or pay for.

- **Additional Insured**

  An "additional" insured is merely a person whose name appears on the policy as such and does not have ownership or control of the policy. An additional insured does not have the rights of a named insured as noted above. An additional insured must rely on the named insured to process the additional insured's claim under the policy if a loss occurs. The insurance company is bound to pay, but only the named insured can bring the action against the insurance company if required. The additional insured does not have the same degree of control over how the named insured uses any insurance proceeds, since the additional insured is not named on the insurance company's settlement cheque to the named insured.

  Often leases will require the Tenant to name the Landlord as a named or additional insured on all of the Tenant's policies. With respect to the Tenant's property damage insurance policy, there is not always a reason to include the Landlord as an insured. Property owned exclusively by the Tenant (e.g. inventory, chattels) should be acknowledged not to be subject to the additional insured endorsement, since it is not property in respect of which the Landlord has an insurable interest.

- **Loss Payee "as its interests may appear"**

  A "loss payee" is a person referenced in a loss payable clause. A loss payable clause in an insurance policy permits the policyholder to direct the insurance company to pay loss due to the policyholder to another party. Usually the cheque is payable to both the insured and the designated payee. Sometimes it's easier to negotiate into a lease that the Landlord will not be an additional insured but rather will be a loss payee, with respect to leasehold improvements only, as

its interests may appear. This saves the Tenant the awkwardness of naming one landlord as an additional insured on its policy which covers multiple locations. It also gives the Landlord the protection it wants with respect to leasehold improvements.

- **Waiver of Subrogation/Prior Release**

This is a condition of an insurance policy which states that the coverage will not be prejudiced if the insured has waived/released in writing, prior to a loss, any rights of recovery it may have from a party responsible for the loss. Without this waiver, an insurer pays out a claim to its insured and then stands in the insured's position (subrogates) and is entitled to pursue the claim against the party who caused the loss. If the Lease states that the Tenant releases the Landlord from claims for damage, the Landlord will nevertheless want the Tenant's insurance policy to contain a waiver of subrogation, so that the Landlord will be sure that the Tenant's insurer will respect the fact that the Tenant released the Landlord and thus the insurer will also not pursue the claim against the Landlord.

There is considerable debate about whether an extra premium is payable to obtain a waiver of subrogation endorsement on an insurance policy. Insurance agents will generally always claim that "it can't be done", or in round 2 they will claim that "it's too expensive". Many insurance companies readily acknowledge that they charge no fee for the endorsement.

The Tenant may wish to have the Landlord's insurance policy contain a waiver of subrogation in favour of the Tenant. If the Lease releases the Tenant for damage it causes to the Landlord, the Landlord has no claim against the Tenant and it is questionable whether the waiver of subrogation is necessary. Most landlords resist the administrative nuisance of having to obtain a waiver of subrogation in favour of any tenant.

- **Co-Insurance**

A co-insurance clause in a property insurance policy requires the insured to maintain insurance at least equal to a stipulated percentage of value (usually 80%), in order to collect partial losses in full. So for example, if the Tenant insures property valued at $500,000, the stated amount of insurance needed to achieve 80% of the value of the insured property at the time of the loss is $400,000, but if the insured (the Tenant) has only placed insurance for $300,000, then in case of damage where the amount of the loss is $100,000, then even though there is ample insurance (up to the $300,000 stated amount), the insured will only recover a portion of its loss as follows:

$$\text{loss} - \frac{\text{insurance required} - \text{insurance carried}}{\text{insurance required}} \times \text{loss}$$

or in other words, the insured will only recover:

$$\$100{,}000 - \left(\frac{\$400{,}000 - \$300{,}000}{\$400{,}000} \times \$100{,}000\right) = \$75{,}000$$

Even if the required amount of insurance is maintained at the beginning of the policy period, the addition of new improvements to the premises, or inflation, could result in the minimum required amount not being complied with at the time of loss. To avoid this, a property damage insurance policy can contain a "stated amount co-insurance clause", which states that the insurer waives the co-insurance requirement if the insured maintains insurance equal to an amount agreed upon and stipulated at the inception of the policy. Or, for an extra premium cost, the co-insurance clause could be waived completely.

- **Primary and Non-Contributing**

  If there is more than one insurance policy in place with respect to damage to insured property, all of the various insurance companies are required to contribute to payment in respect of the loss. Since landlords' insurance may overlap with tenants' insurance, especially with respect to leasehold improvements (which are typically installed by tenants but become property of the landlord immediately upon installation), it is prudent for a landlord to obtain an acknowledgment in the policy of insurance placed by the tenant that the policy is non-contributing with any other insurance, and that it applies as primary insurance and not as excess to any other insurance. By obtaining this acknowledgment, the tenant's insurance company cannot require the landlord's insurance company to contribute when damage occurs, thus keeping the landlord's insurance premiums lower. (The landlord's policy would, however, come into play in case of a loss where the tenant failed to maintain the required insurance.)

- **Standard Mortgage Clause**

  Most mortgage companies like to have a specific clause included in the insurance policies covering mortgaged property. The mortgagee typically does not place its own insurance but relies on the presence of insurance placed by landlords, tenants etc. The mortgage clause usually affords certain rights to the mortgagee (for instance, that the loss payments will be payable to the mortgagor and the mortgagee as their interests may appear, that the mortgagee's right of recovery from the insurer will not be adversely affected by any act or failure to act by the mortgagee, etc.). The landlord will most likely have agreed, under the terms of its mortgage, to include the standard mortgage clause in its own insurance policies, and to require of its tenants that their insurance also (name the mortgagee as an additional insured and) contain the standard mortgage clause.

- **Joint Loss Agreement**

  Sometimes where damage occurs it is not clear whether the tenant's property insurance policy should respond to the loss, or whether its boiler and machinery policy should respond to the loss. While this gets sorted out, the tenant can suffer from a delay in payment. A joint loss agreement ensures that each of the property insurer and the boiler and machinery insurer pays a pre-determined share at the outset, subject to re-adjustment after the liability of each insurer is ultimately determined. A landlord will want to ensure that its tenant has a joint loss agreement in place, if its tenant is one who is required to carry both property damage and boiler and machinery insurance, since it will not want to have to wait for the liabilities of each insurer to be sorted out before repairs can commence. Nowadays there is an industry-wide agreement which has been signed by many property insurance companies and boiler and machinery insurance companies, so that amongst those companies, a joint loss agreement endorsement is unnecessary. However, if the tenant is required to carry both types of insurance, its landlord would be wise to require either the joint loss agreement endorsement or evidence that its insurance companies are signatories of the industry-wide agreement.

- **Self-Insurance**

  This is an over-used phrase that can have dual meaning. Tenants will often seek the right to self insure for the various types of insurance coverage that landlords will require the tenant to place under the terms of its lease. Business interruption and plate glass coverage are the two most frequently addressed in this regard.

Some businesses are so large and sophisticated that they have set aside realistic contingency funds to call upon in case of a catastrophe. Many such businesses continually feed money to the contingency fund and have something similar to an insurance programme in place. But, the programme is privately run and is therefore susceptible to being wiped out by a single catastrophic event or even a change in management philosophy.

Most businesses do not have such a programme in place, and if they seek the right to self-insure they are really asking for approval not to place any insurance whatsoever. The rationale is, "we'll fund the loss out of our own pocket, it happens so infrequently that it costs us less to pay the entire amount of the loss than to place the insurance coverage". This may or may not be true.

The risk management provisions of the lease are generally predicated on insurance being in place. If the Landlord agrees to permit the Tenant to self-insure, as a result of which the Tenant basically does not insure, some release and indemnity provisions of the Lease may operate to the Tenant's advantage (e.g. the Tenant releases the Landlord for damage caused by the Landlord's negligence to the extent the Tenant is insured for the damage and receives proceeds). Thus, it becomes important to add a statement (if the Tenant is permitted to self insure) to acknowledge that if the Tenant does so self-insure, it will nevertheless be deemed, for the purposes of the other provisions of the Lease, to have satisfactorily placed the insurance called for in the lease and to have received proceeds therefrom.

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