Insurance Considerations for Commercial Leases

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I. FORMS OF INSURANCE - OVERVIEW

A. Third Party Policy - Examples

1. Commercial General Liability Insurance (CGL)
   (a) Traditional CGL Policy
   (b) Wrap-Up Policy (“OCIP” or “CCIP”)
2. Excess/Umbrella Liability
3. Automobile (3rd party and 1st party)
4. Workers Compensation
5. Errors & Omissions (E&O)/Professional Liability Policies
6. Directors & Officers (D&O)
7. Employment Practices Liability Insurance (EPLI)

B. First Party Policy - Examples

1. Commercial Property
2. Builder’s Risk Insurance

C. Other Insurance Alternatives

1. Captive Policies
2. Fronting Policies
3. Risk Retention Groups

II. 3RD PARTY/LIABILITY INSURANCE

A. Commercial General Liability Insurance

1. **Summary of Coverage.** A CGL policy provides legal defense and indemnity of named and additional insureds for lawsuits involving claims of bodily injury, property damage, personal injury and advertising injury suffered by a third party. It does not provide coverage for damage to property owned, rented or occupied by the insured. It does not provide coverage for purely economic loss.

2. **Duty to Defend and Duty to Indemnify.** The CGL policy imposes two distinct obligations upon the insurance company:

   (a) the duty to defend; and
(b) the duty to indemnify.

3. **Occurrence vs. Claims-Made.**

   (a) Occurrence: provides coverage for a loss that occurs during the policy period, regardless of when the claim is first made.

   (b) Claims Made: provides coverage for a loss if the claim is filed during the policy period only.

4. **Limits.** CGL policies have at least two limits:

   (a) Per occurrence limit; and

   (b) General aggregate limit. (In addition, most CGL policies have a separate completed operations aggregate limit.)

   Aggregate limits can be applied on a “per location” basis per endorsement. **Note:** defense costs: may be in addition to listed limits (“outside limits”) or may “burn” limits (“inside limits”).

5. **Who is an Insured.** Always check the policy language but, generally, if the named insured is a corporation its employees, directors, executive officers and stockholders will be insureds for purposes of liability in those capacities.

6. **Additional Insured Coverage.** Other parties may require coverage under a named insured’s CGL policy (e.g., a developer, lender or landlord). An additional insured endorsement can provide such coverage. The specific language of the endorsement will determine the nature of the additional insured’s coverage, but usually it is limited to coverage for liabilities arising from the named insured’s activities or operations and does not cover liabilities arising out of the additional insured’s own conduct.

7. **Traditional CGL v. Wrap.** A “Wrap” or “Wrap-up” policy, a/k/a as the “Owner Controlled Insurance Program” (“OCIP”) is a liability policy purchased by the owner/developer covering not just the owner developer, but also the general contractor, contractors and subcontractors on the construction project. Sometimes, it is the general contractor who obtains the policy (a “CCIP” or “Contractor Controlled Insurance Program”).

8. **Other Typical CGL Terms/Requirements.**

   (a) **Contractual Liability coverage.** Coverage for tort liability assumed under the indemnity agreement (e.g., in lease), but coverage only extends to liability assumed for bodily injury, property damage, personal injury and advertising injury.
(b) **Personal Injury Coverage.**

(1) Coverage for claims relating to wrongful eviction from, wrongful entry into or invasion of the right of private occupancy of a room, dwelling or premises that a *person* occupies, committed by or on behalf of its owner landlord or lessor.

(a) Due to definition, insurer may argue that coverage does not extend to claims by business entity tenant, as it is not a *person*.

(b) Attempt to modify policy language to “a person or organization.”

(2) Also, false arrest, malicious prosecution, libel or slander of a person or organization by oral or written publication, and violation of right of privacy by oral or written publication.

(c) **Cross-liability and Severability of Interest Clauses**

(1) Cross-liability coverage permits one insured to access the benefits of the policy where there is a claim by one insured against another. Common to specify in insurance requirements, “no insured v. insured exclusion or limitation.”

(2) Severability of Interest or Separation of Insureds clause requires the insurance to apply to each covered entity as if each had a separate policy.

(d) **Products/Completed Operations Coverage.** Products/completed operations hazard coverage provides coverage for claims arising out of products sold and operations completed by the insured (e.g., construction defect claims).

(e) **Broad Form Property Damage.** Normally damage caused by named insured to own work is excluded; standard BFPD endorsement/policy language extends coverage for completed operations claims arising out of work performed on behalf of named insured by subcontractors.

B. **Deductibles and Self-Insured Retentions (“SIRs”)**

1. **Deductible:** the portion of any claim that the insured agrees to pay; may apply only to indemnity/settlement costs or also to defense costs.
2. **Self-Insured Retention**: the portion of a risk or potential loss assumed by an insured; insurer generally will have no obligation under the policy until the insured incurs defined costs in excess of the SIR.

C. **Excess/Umbrella Coverage**
   
   1. An *umbrella* policy may provide excess limits over a number of policies and may provide broader coverage than underlying policy(ies).
   
   2. An *excess* policy generally provides coverage on same terms of underlying primary policy (“follows form”), but at higher limits.
   
   3. **“Follow Form Coverage”**: excess policy will follow the terms, definitions, conditions and exclusions of the scheduled underlying insurance unless they have their own contrary term, definition, condition or exclusion.

III. **1ST PARTY/PROPERTY INSURANCE**

A. **Nature of Coverage**

   1. **Property Policies.** Property policies provide coverage for the insured’s own property. For real estate, there are two types of property policies: commercial property and builder’s risk policies.


B. **Commercial Property Coverage**

   1. **Scope of Property Coverage.**
      
      (a) **“All Risk” or “Special Causes of Loss”** covers all risks of loss except those specifically excluded by the policy.

      (b) Compare, **Named Perils or Basic Form coverage** (which generally only covers perils specifically named in the policy, such as fire, lightening, windstorm, hail, explosion, riot or civil commotion, aircraft, vehicles, smoke, vandalism or malicious mischief, theft and volcanic eruption).

      (c) Neither earthquake nor earthquake sprinkler leakage insurance is included in “all risk” policies, unless they are endorsed.

   2. **Valuation of Loss.**

      (a) **“Replacement cost”** means the actual cost to repair or replace the damaged property, without depreciation.
(b) **Compare.** “**Actual cash value**” means the value of the property at the time of loss, in its depreciated condition.

(c) **Limits.** The insured should require limits which are equal/exceed cost to replace the physical improvements, structure or other property (land not insured) in event of total loss.

(d) **Coinsurance Penalty.**

(1) Penalty imposed on insured for underreporting value of insured property.

(2) If limits are less than the actual value, then partial loss will be paid on pro-rata basis (e.g., policy for $1,000,000 building has 80% coinsurance clause, loss is $200,000, limits were low at $600,000, payout will be $150,000 ($600,000 / ($1,000,000 x 80%) x $200,000)).

(e) **Agreed Amount Endorsement:** agreement between the insured and the insurer that the property is fully insured and that no coinsurance penalty will apply.

3. **Business Interruption Coverage.**

(a) Policy language varies greatly, but business interruption insurance generally covers indirect losses resulting from a business not being able to operate normally due to direct damages to the property from a covered peril (e.g., fire). Coverage can include lost “business income”, which can be defined to include net profits and normal operating expenses, and will be subject to time limitations and sub-limits.

(1) For tenant, business interruption coverage will pay for its lost income resulting from covered loss (e.g., lost profits due to fire) for specified period (often 12 months or until project repaired).

(2) For landlord, business interruption coverage can include landlord’s lost rent and rental value.

(b) **Extra Expense Coverage.** Provides additional insurance to cover expenses involved in continuing operations at another location (e.g., temporary space), or taken to lower business interruption loss at the insured premises.
4. **Additional Coverages.**

(a) **Ordinance/Law Coverage.** Coverage for increased costs after a loss due to ordinances or laws which govern repair, rebuilding (e.g., code requirements). The newer the building, the less need there will be for this type of coverage.

(b) **Boiler & Machinery Coverage.** Also known as “equipment breakdown insurance”; coverage may include communications equipment, certain computer equipment and power generation and transmission machinery, although will vary from policy to policy.

(c) **Utility Interruption Coverage.** Coverage available by endorsement from some carriers. Most property insurance/business interruption forms exclude coverage for utility interruptions. Generally, property damage on your property due to a utility failure caused offsite or anywhere outside the covered building will not be covered unless a covered cause results (e.g., fire), itself causing damage. In addition, an interruption caused by the negligence of a landlord or its agents/contractors would not likely be covered due to the frequent exclusions in such policies for negligent work, maintenance, etc.

C. **Builder’s Risk Policy**

1. Property policies tailored to construction projects.

2. A builder’s risk policy will provide coverage for the property under construction, as well as coverage for property in transit and off-site storage of building materials. (A standard commercial property policy may provide coverage for minor renovations, but will not usually cover the risks associated with a significant construction project. Nor will it normally provide coverage for property in transit or stored off-site.)

IV. **WORKERS COMPENSATION INSURANCE**

A. **Workers compensation coverage.** Required by law, purchased by company to provide exclusive coverage for claims by its workers for injuries sustained in course of employment.

B. **Employer’s liability coverage.** Typically included as a separate coverage within workers’ compensation policies; provides coverage to the employer for the rare instance when employee has the right to bring a civil action due to bodily injuries against the employer for conduct outside the normal risk of employment (violence, false imprisonment, etc.) or where employee is not subject to workers compensation law.
C. **Why Waiver of Subrogation Required?** Without waiver, workers compensation carrier may sue landlord or other allegedly responsible parties to recover the money it spends on injured worker.

V. **INSURANCE DOCUMENTATION**

A. **Certificate of Insurance**

1. Evidence of liability insurance policies, including key policy terms (carrier, named insured, policy term, limits, cancellation, additional insureds).

2. Key Issues

   (a) Usually not binding on insurer.

   (b) Named Insured – confirm that the appropriate party is accurately shown as named insured.

   (c) Use to confirm limits and policy period (policy period may end before expiration of lease).

   (d) Additional Insured – confirm that the appropriate party is accurately described as additional insured on certificate (and on a.i. endorsement).

   (e) Cancellation – insurance requirement typically mandate notification by lessee of notice of cancellation and removal of “endeavor to” and “no liability” language from cancellation clause:

   “CANCELLATION: SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING COMPANY WILL ENDEAVOR TO MAIL 30 DAYS NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT FAILURE TO MAIL SUCH NOTICE SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE COMPANY, ITS AGENTS OR REPRESENTATIVES.”

B. **Additional Insured Endorsement**

1. Method by which third party (additional insured) is made an insured under another’s (Named Insured) general liability policy. Usually additional insured is granted coverage for liability arising out of operations of Named Insured, not for liabilities arising out of its own conduct. Endorsement forms can vary; the wording of the endorsement will control the coverage extended to additional insured.
2. **Endorsement Forms.**

   (a) **ISO Form CG 20 26 11 85**, “Designated Person or Organization,” is the best for the additional insured, but not always available (includes a designated person or organization as an additional insured, for liability caused by the named insured's activities or operations on the insured’s premises).

   (b) **ISO Form CG 20 11 11 85**, “Managers or Lessors of Premises” (provides coverage for the lessor of premises that the named insured rents and occupies).

   (c) “**Primary, non-contributory**” requirements – ensures that tenant’s insurer will cover landlord without demanding that landlord’s insurer share costs.

3. **Key Issue - Administration.**

   (a) Review certificates and endorsements to confirm correct entities, coverage, limits.

   (b) Request new certificates and endorsement ahead of end of policy period.

   (c) Confirm primary coverage endorsement.

C. **Evidence of Property Insurance**

   1. Provides evidence of property policy, key terms (carrier, named insured, policy term, property location, limits, cancellation, mortgagee/loss payee).

   2. Should be binding on carrier if issued by carrier or its agent.

D. **Loss Payable Endorsement**

   1. Designates loss payee on property policy.

   2. The proper provision allows the loss payee to collect and/or control the insurance proceeds if there is a loss on the property, such as a fire which destroys the building. It may also allow the loss payee to obtain insurance proceeds even if the insured is in breach of the policy.

VI. **INSURANCE COMPANIES, BROKERS AND AGENTS**

   A. **Standard or Admitted Insurers**

      1. Purchased Through Retail Brokers.

      2. Insured Protected by California Insurance Guaranty Association (CIGA).
B. Non-Standard Surplus Lines Insurers
   1. Purchased Through Wholesale Broker.
   2. No CIGA Coverage.

C. Ratings by A.M. Best Company
   1. **Typical Insurance Requirement.** Maintain coverage with “insurance carriers qualified to do business in the state of California and maintaining a rating of not less than A:X from A.M. Best & Co., unless Owner, in writing, in its sole discretion, accepts a lower Best’s rating.”
   2. **A.M. Best.** Provides benchmarks to compare the stability of insurers; higher the rating, less chance insurer will fail (www.ambest.com).
   3. **Financial Strength Rating.** Opinion of ability of insurer to meet obligation to policy holders.
      (a) “Secure” (A++, A+, A, A-, B++, B+)
      (b) “Vulnerable” (B- and lower)
   4. **Financial Size Category.** Indicator of the size of a company in terms of its statutory surplus and related accounts.
      (a) E.g., “X” means a company with adjusted policyholder surplus of at least $500 million.

D. Insurance Broker v. Agent
   1. **Broker** usually represents the insured and, generally, cannot bind the insurance company.
   2. **Agent** solicits, negotiates and places policies on behalf of insurance company.

VII. WAIVERS OF SUBROGATION

A. **Definition:** Subrogation is the right of an insurer to step into the shoes of its insured after a loss to sue a “responsible” party (in the absence of a contractual waiver).

B. **Method of Waiver**
   1. **By endorsement** - an express subrogation waiver endorsement from the carrier is required.
2. **Automatic waiver** - many policies allow an insured to waive the carrier’s right to subrogate as long as the insured’s agreement was executed per a written contract before the loss.

3. Agreeing to waiver without endorsement or automatic waiver subrogation in policy – waiving subrogation right may run insured afoul of policy’s *no voluntary payments* provision or void the coverage.

C. **Property Policies**

1. Waiver generally limited to property loss insured against.

2. Losses falling outside property insurance would be subject to indemnification language.

D. **Workers Compensation Policies**

1. Today, waivers are not 100% available from workers compensation carriers.

2. Without waiver, workers compensation carrier may sue landlord or other allegedly responsible parties to recover the money it spends on injured worker.

E. **CGL Policies**

1. Insurer cannot sue its own insured; so landlord protected if it is named as an additional insured.

2. Endorsement may address this, as well (waiver afforded where required by written contract executed before loss). Note that endorsement terms vary and could restrict the reach of the waiver.

VIII. **EXCULPATION AND INDEMNIFICATION**

A. **Exculpatory Clauses**

1. Generally, an agreement intended to relieve a party from liability to the other for its negligence or other conduct/wrongdoing.

2. Unenforceable where, *e.g.*, parties are of unequal bargaining power, court finds provision to be adhesive.

3. General exculpation clause will not extend to cover landlord’s active negligence; however, specific, nonadhesive exculpation for active negligence may be enforceable.
B. Indemnification

1. Generally, an agreement whereby one party (tenant) agrees to defend and indemnify the other party (landlord) from all specified claims, *e.g.*, tenant’s use of premises.

2. Scope of indemnity determined by specific provision, which may require indemnitor to defend indemnitee against claims regardless of ultimate liability, may exclude indemnification for indemnitee’s own negligence acts or omissions, *etc*.

3. Scope of indemnity may potentially be broader than indemnitor’s insurance coverage (contractual liability coverage typically interpreted to apply to tort liability only).