

Risk Management

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Any commercial agreement involves risk. Several provisions common to commercial leases are intended to spread the costs of those risks to the appropriate parties.

A. Insurance

One way to reduce the costs of risks is through an insurance provision for both the landlord and the tenant. Most often in commercial leases tenants pay for the landlord's insurance costs. Tenants should carefully examine what type of insurance landlords are carrying and what it covers to ensure there is adequate coverage and there are no unnecessary expenses. Insurance is only meant to put the insured party in as good of a position as he was before, and not in a better one. Insurance provisions should also be carefully reviewed because insurance sections on many commercial leases do not tend to accurately reflect current practices. It is important to note that different insurers will use different terms in their policies. Different terms may have different meanings among insurers. Landlords will want to allow themselves the ability to change insurance requirements in case the landlord's mortgagee changes its requirements.

A landlord will often want to be named as an "additional insured" in the tenant's insurance policy. As an additional insured, the landlord is not responsible for making premium payments, but does have the benefit of the policy's coverage. Landlords should also ensure the tenant's policy is "primary" without contributing to a separate policy. This will allow the landlord to avoid distribution problems with having two policies.

There are two primary types of insurance most commonly featured in commercial leases; property insurance and liability insurance.

(1) Property insurance is called “first party” insurance because the insurer pays the proceeds directly to the insured party. Landlords should make certain they have adequate property insurance. Property insurance should cover damage to buildings, equipment, and leasehold improvements. Normally in commercial leases, the tenant will pay for its own separate property insurance to cover its personal property.

There are two basic types of property insurance; “Special Form” and “Named Perils.” The only difference between them is how the coverage is stated.

“*Special Form*” property insurance covers all damage to insured property unless the cause is an exception listed in the policy. This is also the most common type of policy used in commercial leases. It was previously referred to as “All Risk” insurance. However, it is technically not an “all risk” policy, and the name has changed.

“*Named Perils*” property insurance only covers damage to insured property by those causes listed in the policy. Commonly listed perils include floods, tornadoes, and hurricanes.

(2) Liability insurance is called “third party” insurance because the insurer pays the proceeds to a third party who is asserting a claim against the insured party. Liability insurance is intended to cover both the tenant and the landlord against third parties. The most common type of liability insurance is commercial general liability insurance (CGL). The CGL policy has three specific areas of coverage: bodily injury and property damage; advertising and personal injury; and medical costs. Other types of liability insurance include employer’s liability and professional liability insurance.

In addition to these more standard insurance provisions, certain tenants and landlords may want to consider endorsements which will provide additional coverage.

Endorsements tend to cover consequential losses as opposed to direct losses resulting from a covered cause. There are additional provisions for specific concerns and they may be appropriate depending on the business or situation.

Rent Loss Insurance: This covers the landlord for lost rent when the premises are made untenable by a covered loss. Either the tenant or the landlord may want to consider rent insurance depending on who is most concerned about rent payments.

Builder's Risk Insurance: This covers property damage resulting from construction or improvements to the premises. The end of this insurance should coincide with the beginning of the tenant's and landlord's property insurance.

Business Interruption Insurance: It covers the tenant for losses relating to interruptions in business operations from a covered peril.

Ordinance of Law endorsements: This is used to cover costs for upgrading facilities to meet codes and regulations.

Liability insurance policies can be written in two ways. The insurance can either follow the "per occurrence" model or the "claims made" model. "Per occurrence" covers all injury and damage that occurred during the policy period, regardless of when the actual claim is made. "Claims made", on the other hand, only covers injury and damage losses that are brought as a claim during the policy period. Most commercial leases follow a "per occurrence" model.

A sample insurance provision:

Tenant shall maintain public liability insurance in form and substance reasonably satisfactory to Landlord, with an insurer licensed to do business in the State of Minnesota reasonably satisfactory to Landlord, and with minimum limits of liability of _____ Dollars (\$_____), combined single limit. Landlord (and if requested by Landlord, Landlord's mortgagee) shall be named as additional insureds and such insurance shall be primary coverage without right of contribution from similar insurance maintained by Landlord. Tenant shall also be required to maintain, at its own expense, insurance covering (i) breakage of plate glass in the Premises, (ii) Tenant's improvements other than the initial leasehold improvements to the Premises, personal property, supplies and equipment, in an amount equal to the replacement cost thereof, and (iii) Tenant's liability under the agreement to indemnify and defend contained in this Article__. The amounts of coverage for any insurance required to be maintained by Tenant under this Lease shall be adjusted by Landlord after consultation with Tenant at the conclusion of each three (3) year period during the Term to an amount which, in Landlord's opinion, is commercially reasonable. Tenant shall provide Landlord with duplicates of policies evidencing the required insurance to be carried by Tenant hereunder. Such insurance shall provide that Landlord and Landlord's mortgagee shall be given at least thirty (30) days notice prior to any cancellation, non-renewal or modification. If Tenant fails to obtain the insurance called for hereunder, Landlord may obtain such insurance at Tenant's expense. Failure to provide Landlord with copies of those policies shall be deemed to be a failure by Tenant to obtain the required insurance. Tenant agrees not to maintain or store any material in or about the Premises which would in any way impair or invalidate any of the insurance required to be maintained by Tenant. If Tenant uses the Premises so as to cause an increase in the cost of insurance on the Land or Building, Tenant shall be responsible for paying any such increase.

Landlord and Tenant hereby release one another from any and all liability or responsibility (to the other or anyone claiming through or under them by way of subrogation or otherwise) for any loss or damage covered by property insurance or coverable by a customary policy of the insurance required by this Lease even if such loss or damage shall have been caused by the fault or negligence of the other

party or anyone for whom such party may be responsible. To that end, Landlord shall not be liable to Tenant for any damage occasioned, among other things, by bursting, stopping, leaking or running of any systems, facilities or pipes in or about the Building, and Tenant agrees that all property kept in the Premises shall be so kept at the risk of Tenant, and that it is up to Tenant to obtain appropriate insurance to cover that risk.

Tenant agrees to indemnify and defend Landlord against any claims, actions, liability and damages of every kind and nature, and against all costs and expenses, including attorney's fees, (cumulatively the "Liabilities") arising out of any occurrence (i) within the Premises, (ii) occasioned wholly or in part by the use and occupancy of the Premises, (iii) related to the business conducted by Tenant in the Premises, or (iv) from any act or failure to act of Tenant, its agents, employees, sublesses, concessionaires, licensees or contractors. Tenant further agrees to indemnify Landlord from any Liabilities arising out of a default by Tenant under this Lease, including the failure to conform to applicable environmental laws. This indemnification shall survive the termination of this Lease.

Subject to the provisions of Section __ of this Lease, Landlord agrees to indemnify and defend Tenant against any claims, actions, damages or liability of every kind and nature, and against all costs and expenses, including reasonable attorney's fees, arising out of any occurrence in the Building (other than the Premises) to the extent the same is attributable to the negligence of intentional misconduct of the Landlord, its agents, or employees.

B. Indemnity and Exculpatory Clauses

Indemnity Clauses ensure protection against third party claims. There is no legal requirement for indemnity clauses. But indemnity clauses help to ensure liability and losses are directed at a certain party, so both parties can know what to expect. For example, a tenant may assume the liability for all third party claims for personal injury or property damage made against a landlord. If a patron breaks her purse or slips on the floor, the tenant assumes the risk of liability. Hopefully in this case, the tenant already has insurance to cover the third party claims, so the landlord will not have to, thus

avoiding overlapping insurance. Indemnity clauses help to allocate the risks to the appropriate party with insurance to cover those risks. Each party should examine the indemnity clause carefully to ensure they are not assuming a risk that they would not be exposed to ordinarily under common law. Indemnity clauses may have a landlord indemnify a tenant, or a tenant may indemnify a landlord. Most often the tenant indemnifies the landlord. In that case, indemnification clauses will usually list all of the things the landlord is indemnified against.

Indemnification clauses operate in two ways. The provisions can either specify a person or a place against which the provision indemnifies. For example, a provision may indemnify the landlord for any claims arising from the tenant's premises. Alternatively, the provision may indemnify the tenant for any losses caused by the landlord.

Indemnification does not provide absolutely complete protection. Public policy strongly discourages insurance and indemnifications from protecting landlords for willful or malicious acts.

Exculpatory Clauses: Exculpatory clauses are similar to indemnity clauses. Exculpatory clauses relieve the landlord from all liability resulting from damage or injury occurring on the premises, whether the landlord caused it or not. This provision may appear to insulate landlords significantly, but these clauses are limited by statutes and case law. Landlords may attempt to broaden exculpatory clauses by stating tenants accept premises "as is." However, this still does not relieve a landlord from repairing and keeping up certain areas of the premises. When they are enforced, exculpatory clauses are enforced against the landlord.

Exculpatory clauses are generally for negligence, and should a court find the clause enforceable a plaintiff can try to go around it by bringing a claim other than negligence. Exculpatory clauses protecting against a landlord's negligence cannot be assumed by third parties. For example, a building supervisor cannot assume protection under an exculpatory clause that names the landlord.

C. Casualty

Casualty insurance is "first party" insurance, similar to property insurance. The insurer pays the insurer directly for its losses. Common casualty policies have three coverage options: Basic Form, which covers damage caused by fire and vandals; Broad Form, which covers damage from additional sources; and Special Form, which lists specific exceptions to the coverage.

A sample casualty clause:

If more than twenty percent (20%) of the Building is damaged by casualty, Landlord may terminate this Lease provided it gives Tenant notice within ninety (90) days of the damage. If this Lease is not so terminated, Landlord shall promptly restore the Premises to as near the condition which existed immediately prior to such casualty as may be reasonably possible; however, Landlord shall not be required to spend amounts in excess of the insurance proceeds made available to Landlord or to restore any improvements made by Tenant subsequent to the Commencement Date. Whether or not Landlord elects to restore the Building, Tenant's obligation to pay monthly installments of Base Rent shall abate during such period of time that the Premises are untenable in the proportion that the untenable portions of the Premises bears to the entire Premises. When Landlord has completed its work required hereunder, Tenant's obligation to pay Base Rent shall resume and Tenant shall promptly complete the restoration of the Premises to the condition which existed immediately prior to the casualty. In the event Landlord has not restored the Premises to a tenable condition within one hundred twenty (120) days of Landlord's notice that it intends to restore, Tenant may terminate this Lease upon thirty (30) days written notice to Landlord.

D. Hazardous Materials

The dominating government statute regulating environmental standards is the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). It outlines the responsibilities and liabilities of various parties in a lease depending on the term and control of premises by the tenant. The tenant and the landlord may be liable for environmental damage in different capacities; the landlord as owner, and the tenant as operator. It is the interest of both parties to ensure compliance with environmental laws.

There are certain precautions and safeguards a tenant or landlord may pursue to ensure the premises and the building do not contain hazardous or dangerous materials. For example, a tenant may ask for a warranty and indemnity against asbestos, PCBs, or radioactive material.

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