

# **Insurance Clauses in Commercial Leases (Gross and Net)**

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**A. Introduction.**

A signed commercial lease is the end-product of much negotiation between the landlord, the tenant, brokers (sometimes) and their respective legal counsel. Each party seeks to pass as much responsibility and liability for the leased premises to the other party. Of course, it is impossible for both parties to eliminate all risk relative to the lease and at some point in the negotiation process, the parties reach a stalemate in their efforts to shift burdens.

At that point, insurance coverages enter the picture. These materials will discuss the types of insurance coverages available to both landlord and tenant in the context of both gross and net leases.

The type of commercial lease will affect the insurance requirements of both landlord and tenant. There are two types of commercial leases: a gross lease and a net lease.

A gross lease is a type of commercial lease where the landlord pays for the building's property taxes, insurance and maintenance. In a "modified gross lease", however, the tenant may be responsible for some insurance coverage. An example of such a clause is as follows:

Insurance. During the Lease Term, Lessee, at its sole expense, shall keep the building and any other improvements now or hereafter located upon the Leased Premises insured against loss by fire, vandalism, malicious mischief and normal extended coverage risks, with an insurance company acceptable to the Lessor in an amount not less than Two Million Dollars (\$2,000,000.00) without deduction for depreciation.

Lessee shall at all times during the Lease Term procure and maintain at Lessee's expense fire insurance with an extended coverage endorsement insuring the fixtures, merchandise and other personal property owned or installed in the Leased Premises by the Lessee, in an amount not less than Two Million Dollars (\$2,000,000.00) without deduction for depreciation.

Lessee shall place and maintain at all times during the Lease Term, at its expense, a public liability insurance policy covering the Leased Premises and insuring the Lessor with limits of at least Two Million Dollars (\$2,000,000.00) for injury or death to one person, Five Million Dollars (\$5,000,000.00) for any number of persons injured or killed in one accident and Three Hundred Thousand Dollars (\$300,000.00) property damage resulting from any occurrence upon the Leased Premises (including any sidewalk or driveway contiguous to or abutting the Leased Premises).

In case Lessee shall at any time fail, neglect or refuse to insure the building and improvements and to keep the Leased Premises as hereinabove provided, then Lessor may, at its election, procure or renew such insurance. Lessee shall reimburse Lessor for any amounts paid therefor by Lessor no later than the first day of the next calendar month after any such payment.

All insurance requirements herein shall be placed with responsible insurance companies authorized to do business in the State of Minnesota and shall be in a form and for coverage amounts commensurate with industry standards for the restaurant industry in the Twin Cities metropolitan area. All such policies, or certificates of insurance evidencing such coverage, shall be deposited with the Lessor and maintained during the Lease Term. The policies of insurance required in this Section shall contain an undertaking by the respective insurers, that such policies shall not be cancelled or have their coverage materially altered without at least thirty (30) days prior written notice to the Lessor, the Lessee shall furnish Lessor with respect to any expiring policy reasonable evidence of the replacement or extension of such policy and of the payment of the premium with respect thereto.

All such insurance shall be so issued as to cover the several interests of the Lessor, Lessor's mortgagee and the Lessee and shall provide that in case of loss or damage the proceeds thereof shall be payable to the Lessor to be held by it as security for the performance of Lessee's obligation to repair, rebuild or reconstruct the Leased Premises as provided herein.

The opposite of a gross lease is a net lease. Under a net lease, the tenant is responsible for some of the additional costs associated with the property. There are three types of net leases: single net, double net and triple net. Under a single net lease, the tenant pays rent plus property taxes. Under a double net lease, the tenant pays rent plus property taxes and insurance. Under a triple net lease, the tenant pays for rent plus property taxes, insurance and maintenance. A typical insurance clause in a triple net lease is the following:

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 \_\_\_\_\_ reasonably satisfactory to Landlord, and with minimum limits of liability of Two Million Dollars (\$2,000,000), 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. Should Tenant choose not to maintain said insurance, Tenant agrees to indemnify, defend and hold Landlord harmless from and against any and all claims. 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 b 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, it's agents, employees, sublessees, 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.

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. Fire or Casualty Insurance (All Risk)**

There are two types of commercial property insurance. "Named perils" policies cover only those perils that are listed, and "all risk" policies which cover all perils except those which are specifically excluded. Common exclusions under an "all risk" property insurance policy include the following:

- War and nuclear;
- Earth movement;
- Water damage; flood, mudslide, seepage and sewer backup;
- Governmental seizure or destruction of property;
- Off-premises utility service interruption;
- Building ordinance;
- Delay, loss of use and loss of market;
- Smoke, vapor or gas from agricultural or industrial operations;
- Wear and tear; rust, corrosion, fungus, decay, deterioration, hidden or latent defect smog; settling, cracking, shrinking, or expansion; nesting, infestation or release of secretions by insects, birds, rodents or animals;
- Mechanical breakdown;
- Theft of building materials and supplies not yet attached to buildings;
- Pollution;
- Rain, snow, ice or sleet damage to personal property in the open;
- Dampness, dryness, changes or extremes of temperature, and marring or scratching, all with respect to personal property only;
- Boiler explosion;
- Loss to steam and hot water equipment from any condition within the equipment;
- Seepage or leakage of water over a period of 14 or more days;
- Employee dishonesty;
- Theft by trickery; voluntary parting with property and unauthorized transfer of property;

- Weight of snow, ice or sleet on gutters and downspouts;
- Damage to building interiors by rain, snow, sleet, ice, sand, or dust unless the roof or walls are first damaged – except damage by thawing of snow, ice or sleet; and
- Missing property when the only evidence of loss is inventory shortage.

### **C. Public Liability Insurance**

Public liability insurance, also known as commercial general liability insurance or “CGL” insurance, provides coverage for bodily injury and property damage due to alleged negligence of the insured and includes the following elements:

- *Each Occurrence Limit:* The Each Occurrence Limit is the amount that the policy will pay for any one covered lawsuit. Additional limits of coverage can be obtained by purchasing an Umbrella or Excess Liability policy.
- *General Aggregate Limit:* The General Aggregate Limit is a cap that the policy will pay for multiple premises liability and operations liability lawsuits that occur within a 12 month policy period. For example, if your Each Occurrence Limit is \$1,000,000 and your General Aggregate Limit is \$2,000,000, the policy will pay for two \$1,000,000 lawsuits or four \$500,000 lawsuits that occur within the same policy period. The General Aggregate Applies to premises liability and operations liability types of lawsuits that arise out of a hazard in your premises (ex: slip and fall resulting from wet spot) or a dangerous condition in your operations that results in injury to a third party.

- *Products / Completed Operations Aggregate Limit:* This is a special aggregate limit that applies to the product liability types of lawsuits that occur after the product or service has been sold. For example, a distributor sells a piece of sporting goods equipment that is defective and results in injury to a baseball player. Product liability is a critical coverage component.
- *Personal / Advertising Injury Limit:* Typical Personal Injury offenses that may be covered include certain types of slander, libel, false imprisonment, and invasion of property. Advertising Injury occurs when your business unintentionally disparages or makes a misstatement about a competitor in your advertising materials. In addition, certain types of intellectual property violations may be covered on a very limited basis.

Public liability insurance policies are either “claims made” or “occurrence based”. A claims-made policy is type of public liability insurance policy that responds only to claims for injury or damage that are brought (to the insurer) during the policy period (or during a designated extended reporting period beyond expiration). This development was in response to 'long tail' claims, such as those related to asbestosis injury, carrying over many years and multiple layers of coverage limits. However, most public liability policies are written on an 'occurrence' basis, covering injury or damage occurring during the policy period even if a claim is brought months or even years later.

#### **D. Coverage of Tenant Improvements Within the Premises**

Following is sample language regarding tenant’s obligation to insure its improvements:

Tenant shall also be required to maintain, at its own expense, insurance covering... (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

The insurance policies mentioned in Sections (B) and (C) above cover the building, not the tenant's improvements within the leased premises, and the tenant should be required to obtain insurance on its improvements as well as its personal property contained within the leased premises. NOTE: the tenant should insure its improvements and personal property in both the net and gross lease contexts.

**E. Damage and Destruction: Timing and Rights for Rebuilding, Termination, Etc.**

A typical damage destruction clause is as follows:

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 tenantable 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.

**F. Mutual Waiver of Subrogation**

Commercial leases often include a waiver of subrogation provision. The waiver is in effect an agreement between the parties to look to their respective insurance carriers in the event of a covered claim against either party. A waiver of subrogation provision is intended to avoid litigation between the landlord and tenant. In the absence of a waiver, if a landlord's negligence causes damage to a leased premises, the tenant's insurer would pay the loss and then be subrogated to the tenant's rights against the landlord, allowing it

to pursue a claim for indemnity against landlord. Waiver of subrogation provisions prevent these types of actions, theoretically serving the interests of both the landlord and the tenant.

Following is a sample waiver of subrogation clause:

Waiver of Subrogation. All insurance policies carried by either party covering the Premises, including but not limited to contents, fire and casualty insurance, shall expressly waive any right on the part of the insurer against the other party. Neither party, nor its agents, employees or guests, shall be liable to the other for loss or damage caused by any risk covered by such insurance, provided such policies shall be obtainable, and the parties waive all rights of subrogation in this regard.

#### **G. Conclusion**

Determining appropriate types and levels of insurance coverage for your client, whether you represent the landlord or the tenant, is an essential aspect of commercial lease law, as insurance further minimizes the risks to your client associated with the lease transaction.