

SPECIAL REPORT

BUILDING A BETTER LEASE AGREEMENT Key Considerations in Negotiating Landlord Favored Commercial Insurance and Indemnity Provisions

(06-17-08)

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Insurance policies are not fungible commodities. Instead, each policy has different wording and each insurer may add distinct endorsements that could affect coverage. Unfortunately, many policyholders do not learn about this until after a major loss when insurers begin to piece together what coverage exists and how much is owed under the applicable policy contract.

The purpose of this article is to provide commentary and suggestions on what insurance coverage should be required in commercial lease agreements and how that coverage should be confirmed. This is particularly important in triple net leases where the landlord allows the tenant to insure its asset.

The following fifty points come from our experiences as insurance coverage attorneys and brokers involved in placing insurance for many years.

At the end of this article is a sample insurance requirements provision for a commercial lease agreement.

GENERAL CONSIDERATIONS



1. Insurer. Is the insurer rated by A.M. Best Company as an “A” or better and licensed in Michigan or the state where the property is located? It is generally advisable to stay away from surplus lines (nonstandard) insurers where possible given that their forms of coverage can be inferior.

- 2. Insureds. Is the landlord listed as an additional insured on the property policy and not a loss payee? Is the LLC or other entity that actually owns the building listed?
- 3. Is there an increase in hazards provision in the lease?
- 4. Does the lease require that the tenant use only contractors that are licensed and include coverage for general liability and workers compensation?
- 5. Does the lease reserve the right to obtain copies of the policies? Better yet, can specimen copies of policies and endorsements be obtained prior to a closing or effective date of coverage?
- 6. Has the insurer inspected the property or is the insurance quote subject to inspection?
- 7. What compliance systems are being used to assure compliance with the lease insurance provisions?
- 8. Does the lease include specific language per Royal Management case on liability for damage to the premises?
- 9. Is the landlord maintaining a security deposit bond if appropriate?
- 10. Is there a mutual waiver of subrogation in the lease? This may be less of an issue if the landlord and tenant are on the same policy but should still be standard practice.
- 11. Is there a provision in the policies or the certificate that requires notification in the event of cancellation or material change in coverage? Note that most insurers only have to give notice to the first name insured which may not be the landlord. Does the lease contain a requirement of at least 30 days notice?

PROPERTY INSURANCE

- 1. Is the landlord entity listed as an additional insured on the property policy and not a loss payee? Loss payees have not direct rights to coverage so if the policy is voided by the named insured tenant, the landlord would be without coverage as well.
- 2. What is the value of the building insured? For offices is the value at least 120 per square foot? For manufacturing is it at least 75 per square foot?
- 3. Are foundations, underground pipes, flues and drains covered?
- 4. Is a special causes of loss property form required in the lease?
- 5. If there are towers or satellite dishes are they covered?
- 6. What is the deductible? If it exceeds 25k, is there a provision regarding security and also does the lease make the deductible the sole responsibility of the tenant?
- 7. Is machinery breakdown coverage included? What is the average daily value business interruption limit?
- 8. Are flood or earthquake coverages necessary?
- 9. Is the mortgagee listed?
- 10. Has any protective safeguard provision as respects sprinklers or alarms or lightning been waived?
- 11. How long does the policy allow for the insured to rebuild? Actual cash value is usually paid until the building is replaced.
- 12. What is limit for debris removal?
- 13. Is there a coinsurance provision on the building, contents or loss of income coverages?

- 14 Has a statement of values been signed? Some policies indicate that agreed amount coinsurance waivers do not apply absent a signed statement of values.
- 15 What is the limit for loss of rental income? Does the loss of income have a monthly limit of indemnity such as one-third?
- 16 Is the loss of income coverage limited to 12 months? Is that adequate?
- 17 Are the contents such as lobby furniture covered?
- 18 How does the lease treat abatement of rent or lease cancellation in the event of casualty and do these provisions tract with the loss of income coverage?
- 19 What is the extended period of indemnity? Is it more than the automatic 30 days?
- 20 Does the loss of rents coverage include delays for ordinances or laws?
- 21 What are the limits for ordinance or law undamaged portion of the building?
- 22 What are the limits for ordinance or law demolition costs?
- 23 What are the limits for ordinance or law increased costs of construction?

GENERAL LIABILITY

- 1. Is the landlord listed as an additional insured on the general liability?
- 2. If there is a liquor exposure, is the landlord listed as an additional insured on the liquor policy?

- 3. Is there a cross-suits exclusion which would bar one insured from suing another?
- 4. Does the CGL policy have a modified pollution exclusion for heating, cooling or dehumidifying equipment?
- 5. Does the CGL policy include premises and operations, products and completed operations, personal and advertising injury and contractual liability coverages?
- 6. Does the CGL include a modified pollution exclusion for hostile fire?
- 7. Does the landlord maintain a separate CGL policy where it is a named insured? This is often referred to as a lessors risk policy.
- 8. Does the CGL contain a limitation of coverage to designated premises?
- 9. Is the additional insured lessor provision automatic if required by written contract? Such provisions are typically not applicable in the case of any structural alterations

OTHER COVERAGES

- 1. Does the lease require workers' compensation and employers' liability coverage? Note that workers' compensation insurers will not list parties such as a landlord as an additional insured.
- 2. Does the lease require automobile coverage? Is the landlord an additional insured on that policy?
- 3. Environmental. Is a pollution liability policy needed if USTs or chemical exposures?
- 4. What umbrella limit is required? For most leases at least 5m should be required.

5. Does the umbrella include coverage for hostile fires or heating and cooling system fumes?

INDEMNIFICATION

1. Does the indemnity language include the word "defend?"

2. Does the indemnity provision include "on or about the premises?"

3. Is there a separate indemnity as to environmental matters?

4. Is there contractual liability coverage for the indemnity obligations?

SAMPLE INSURANCE REQUIREMENTS PROVISION AND WAIVER OF SUBROGATION

1. Insurance

13.1 Tenant shall, at no expense to Landlord, provide and keep in force the following types of insurance through insurer(s) which hold an A.M. Best rating of "A" or better and which is/are licensed in the state where the premises is located:

- a) Commercial general liability insurance with limits of at least \$1,000,000 per occurrence and \$2,000,000 aggregate. Such policy shall include coverage for premises and operations, products and completed operations, personal and advertising injury and contractual liability insurance that covers the indemnity obligations of this lease. Such policy or policies shall include Landlord, its managing agents and its lenders as additional insureds on a primary and noncontributory basis, as their interests appear. This policy shall include coverage for bodily injury or property damage liability arising out of fumes from hearing or cooling systems or from hostile fires

- b) Workers' Compensation and Employers Liability coverage for the state that the premises is located in. Such policy shall contain a waiver of subrogation in favor of the Landlord.
- c) Commercial automobile coverage for owned, leased, hired and non-owned motor vehicles.
- d) Commercial umbrella or excess liability coverage with limits of at least \$2,000,000 per occurrence and aggregate that provides excess coverage with at least as broad of terms and conditions as the primary commercial general liability, employers' liability and commercial automobile policies referred to above, including coverage for the Landlord, its managing agents and lenders as additional insureds on a primary and noncontributory basis.
- e) Tenant shall require any contractor of Tenant performing work in, on or about the Premises or Tenant's improvements to obtain and maintain insurance with provisions identical to those required above including listing the same parties as additional insureds.
- f) Commercial Property Insurance for Real and Personal Property. Tenant shall also keep and maintain during the term of this Lease a commercial property policy for the described premises on a Special Causes of Loss form as published by the Insurance Services Office or better. Such coverage shall be written with limits of at least 100% of the replacement cost of all buildings (including foundations and underground supports), without coinsurance, for all improvements, alterations and betterments and other real and personal property and shall name the Landlord as an additional insured and not a loss payee. Such coverage shall include at least \$250,000 for increased costs of construction, demolition costs or costs to update the undamaged portion of the building arising out of ordinances, codes or laws. The property policy may contain a deductible provision not exceeding \$10,000, and may be on a blanket basis covering the Premises and other locations in which Tenant has an interest. The property policy shall contain coverage for business income and extra expense for the

Special form causes of loss and shall be for a period coverage of restoration of at least twelve (12) months.

- g) Tenant agrees to deliver certificates of all insurance required under this Section 13.1 to Landlord prior to any entry upon the Premises, and not less than thirty (30) days before the expiration of any policy. Further, Tenant agrees to provide complete copies of all policies to the Landlord upon receipt. In the event of cancellation or material change in any of the above policies, Tenant and its insurer shall agree to provide to Landlord at least 30 days advanced notice of any such change or cancellation.

2. 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.

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