

## **IF THE SHOE FITS WEAR IT - SHOEHORNING WAIVERS OF SUBROGATION INTO COMMERCIAL LEASES**

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No one shoe fits all when it comes to waivers of claims, indemnities and insurance in commercial leases, but there are steps to take in order to get these shoes on the right foot and to properly address the inevitable right of subrogation of the parties' insurance provider. This article discusses these inter-related lease provisions that can make or break a landlord's or a tenant's budget when bad stuff happens to or in a commercial building or elsewhere on the landlord's property regardless of who is at fault.

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## If the Shoe Fits Wear It - Shoehorning Waivers of Subrogation <sup>1</sup> into Commercial Leases -

### I. INTRODUCTION TO RISK MANAGEMENT

#### A. Risk of Personal Injuries and Property Damage

##### 1. Personal Injuries

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A person injured on another's property has two potential common law causes of action against the owner of the property: a **premises liability claim** for an unreasonably dangerous condition on the premises (sometimes referred to as "slip and fall" claims, but a premises liability claim can include many different types of injuries than those that arise when someone simply trips over an unsafe stair, threshold or carpet), or a **negligence claim** for negligent activity on the premises. The common law doctrines of "premises liability"<sup>2</sup> and negligence allocate the risks associated with such claims in the absence of a contractual risk allocation (*i.e.*, a lease provision) or statutory allocation (*e.g.*, workers compensation claims by employees injured on their employer's premises).

When the alleged injury is the result of a negligent activity, the injured party must have been injured by, or as a contemporaneous result of, the activity itself, not by a condition the activity created. The negligent activity theory of liability is applicable where the evidence shows that the injuries were directly related to the activity itself. The elements a claimant is required to prove include that there was a duty of care on the part of the party against whom the claim is made, that duty was breached, the breach caused the claimant's injuries, and the claimant suffered damages as a result.

If the injury was caused by a condition created by an activity (such as the failure to repair a loose stair railing that gives way and causes someone to fall, an unrepaired pothole in a parking lot someone steps into, or a frayed rug or broken tile on a floor someone trips over) rather than the activity itself, the plaintiff claiming

negligent activity is limited to a premises liability theory of recovery.

The elements of a premises liability claim are the following: (1) the cause of the injury is a condition of the property; (2) the condition existed prior to the accident; and (3) the condition posed a general, unreasonable danger to all working on the premises, rather than a specific danger to a person performing a particular activity. *See Coastal Corp v. Torres*, 133 S.W.3d 776, 782 n. 6 (Tex. App. – Corpus Christi 2004, pet. denied). The Texas Supreme Court in *Wilson v. Tex. Parks & Wildlife Dep't*, 8 S.W.3d 634, 635 (Tex. 1999 *per curiam*) observed:

As a rule, to prevail on a premises liability claim, a plaintiff must prove that the defendant possessed – that is, **owned, occupied, or controlled** – the premises where injury occurred. (Emphasis added.)

Of these circumstances, control of the premises is the key element for premises liability, although possession can be sufficient to establish control.<sup>3</sup>

##### 2. Property Damage

Property damage can be caused by so-called "acts of God" (*e.g.*, tornados, windstorms, hail, lightning, wildfires, floods and other natural disasters) or by fires either deliberately set (arson), negligently occurring (*e.g.*, someone leaving flammable materials next to a heater, or a tenant proverbially "leaving the coffee pot on overnight in the office building"), or problems with building systems (*e.g.*, a short circuit in a building electrical system). Generally, but not always, the owner of the premises will insure the buildings and other improvements from damage naturally occurring, but may expect the occupant (*i.e.*, the tenant) to be responsible for damage caused by its own negligence.

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This division of liability would be appropriate, if property insurance were available to a tenant that would cover negligently caused fires or other damage (e.g., an employee hitting a wall with a forklift truck). However, first party <sup>4</sup> property insurance policies, which cover property owned by the insured, historically have not distinguished between who or what caused the damage when determining whether the damage is covered. Instead, first party property policies cover damage caused by certain named perils in the policy, regardless of whether the peril was natural or caused by the owner, tenant or a third party.

Unfortunately, not all reasons why an owner's property might be damaged are included in the perils insured by a property insurance policy. In addition, while there is some property damage insurance coverage contained in a typical third party<sup>5</sup> commercial general liability ("CGL") policy issued by ISO Properties, Inc. ("ISO"), such policies specifically exclude

"Property damage" to (1) **Property you own, rent, or occupy**, including any costs or expenses incurred by you (the insured) or any other person, organization or entity for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property,...<sup>6</sup> (emphasis added)

Often these CGL policies are issued with lesser sublimits for the property damage coverage that is provided. Those sublimits seldom will be as high as the typical limits of \$1,000,000 per occurrence or \$2,000,000 in the aggregate during the policy period, which means it will not be sufficient to repair or restore anything other than modest damage to a landlord's property.

### 3. Leased Premises

A landlord or a tenant might become liable to the other or to a third party for personal injury or property damage during the term of a lease for a myriad of reasons. Who should bear the risk of the loss, as between the landlord, the tenant and their respective insurance companies is a matter

of negotiation between the parties to a lease, but in the absence of a negotiated provision in a lease, who will bear that risk will vary from state to state.

**Questions:** The following list illustrates some of the many property loss and injury risk allocation questions to be addressed in leases:

- Upon a "casualty" loss,<sup>7</sup> what happens to the lease, does it terminate, or does it continue?
- If a casualty loss causes the premises to become untenable, what happens to the rent?
- Who is responsible for the restoration of the premises?
- Are the premises located in special hazard areas, such as flood zones, hurricane or earthquake areas?
- Are there tenant improvements and betterments to the premises? Who is responsible to restore any damage to them?
- Do the tenant's operations at the premises result in invitees coming to the premises or the use of contractors, business autos, or high pressure boilers at the premises?
- Are there special environmental hazards or other extraordinary risks associated with the tenant's use of the premises?
- Who is responsible for injuries occurring on the premises?
- Is the party the landlord and tenant agree should be obligated to protect the other party from a loss or injury financially capable of funding the loss or injury without insurance?
- If rent and income by the parties is interrupted due to the occurrence of an insured event or an insured peril, will the financial stability of either or both of the lease parties be materially adversely affected?
- Is insurance available to fund protection against these risks at a commercially affordable rate? What minimum coverage limits are

reasonable? What deductibles are acceptable? What coverage exclusions and limitations are acceptable?

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## B. Contractual Risk Allocation

Risk allocation provisions are contained in all contracts. They are used in an attempt to assure the intended economic objectives of the “deal.” The success of an entity’s approach to contractual risk transfer can be considered successful if it meets the following criteria:

- Risks retained are appropriate and affordable.
- Risk as an element of the overall transaction and negotiation is accounted for and properly allocated in the lease at the onset of the parties agreement.
- Indemnity, insurance, and other pertinent conditions are not so onerous that contract negotiations drag on unnecessarily delaying the transaction or necessitating the use of second-rate service providers to accomplish the contract’s purpose.
- Contractual conditions allocating risk are not so onerous that a court disallows their operation at a future point in time.
- Insurance requirements are clear, using recognized terms that can be interpreted both at the time the contract is negotiated and in possible future disputes.
- Insurance and other support for the indemnity or loss is in place when a loss occurs.
- A thorough insurance monitoring process keeps the party assuming the risk or to whom the risk is transferred in compliance with the insurance requirements.
- The performance of the contract is monitored and regularly evaluated.

## C. Common Contractual Means of Allocating Risk

### 1. Protecting Party and Protected Party

Every risk allocation provision of a lease or contract is either:

(a) restating the rule that would be supplied by the court in the absence of the provision (the “**common law**”) or is supplied by statute, or

(b) expressly shifting a risk from one party, *e.g.*, a tortfeasor or joint tortfeasor, the released party, the indemnified party (collectively, the “**Protected Party**”) to another person, *e.g.*, the other party, a third party insurer, a releasing party, an indemnifying party (collectively, the “**Protecting Party**”),

to the extent not prohibited by common law and statute.

### 2. Three-Legged Stool

The most common methods of risk management are through three contractual provisions (aka the “**three-legged stool**”):

(a) indemnity,<sup>8</sup>

(b) insurance,<sup>9</sup> and

(c) releases of claims and waivers of subrogation.<sup>10</sup>

Neglecting any one of these three risk management legs may result in a failed risk management program.

### 3. Three Legs

#### a. Indemnity by Protecting Party

The lease may contain contractual risk shifting provisions such as an indemnity.<sup>11</sup> Indemnity is tantamount to taking on the liability of an insurer to the extent of the provisions of the indemnity. An insurer is paid a premium to indemnify and defend the Protected Party. An insurer is in the business of evaluating risk. An insurer is in the business of writing lengthy insurance policies, containing exclusions, conditions, definitions,

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setting out the scope of coverage. Generally, a party to a lease has none of these skills or experience. A party providing an indemnity that is not reinsured by the Protecting Party's insurance runs the risk of an uninsured loss or liability, one which is potentially bankrupting.

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Lease indemnity provisions most commonly cover liability for injuries to persons and property of third parties, rather than to the leased premises itself. If properly drafted, the indemnity will be "covered" by the Protecting Party's CGL insurance. However, landlords often seek to be indemnified for both negligent and intentional acts that cause damage to the leased premises (intentional acts being commonly excluded from coverage under CGL policies).<sup>12</sup>

Some types of damages a landlord wishes to be indemnified for might, in fact, be covered by the landlord's own property insurance, while they may be excluded from coverage in full under the tenant's CGL policy (if the property damage is due to fire)<sup>13</sup> or be of a type that is covered only to the extent of a sublimit in the tenant's CGL policy that is sometimes significantly smaller than the policy's per occurrence or general aggregate limit. Thus, it is important to consider what insurance is available to the Protected Party and the Protecting Party when drafting a lease indemnity provision.

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In some states, landlords are not prohibited from being indemnified for their own negligence, and in other states, such as Illinois, landlords are prohibited by statute from being indemnified against their own negligence.<sup>14</sup> These variations in the laws applicable in different states may mean the same indemnity clauses contained in a "standard" lease form used by a landlord or tenant in multiple jurisdictions will lead to a different result if the same type of occurrence, event, damage or claim arises, depending on the state in which the leased premises are located.

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#### **b. Insurance for Protected Party**

Most leases contain provisions requiring either the landlord or the tenant (or both) to carry insurance (*i.e.*, an indemnity by a paid third party, typically regulated and licensed to provide

loss or liability protection). Typically, this insurance will include:

(1) property insurance protecting against damage to the building, the leased premises, betterments, alterations, fixtures, rent, and personal property, or various combinations thereof caused by certain perils (often unartfully called "casualty losses" in leases);<sup>15</sup> and

(2) liability insurance protecting against legal liability for injuries or deaths or damage to property of third parties caused by the acts or omissions of either or both of the lease parties or by persons for whom they are legally responsible.

Where the landlord is an additional insured under the tenant's CGL policy, depending on the wording of the additional insured provision in that policy or in an additional insured endorsement to that policy, contrary to what some landlords may expect, the landlord may not be defended or indemnified by the tenant's CGL policy if the landlord's own acts or omissions or the acts of someone acting on behalf of the landlord were the cause of the injury or damage and the tenant was not at least in part the cause of the injury or damage.<sup>16</sup> Thus, the landlord should still procure its own liability insurance even if the tenant has added the landlord as an additional insured on the tenant's CGL policy.

Property and liability insurance policies almost universally include a right on behalf of the insurer, after it pays a loss on behalf of its insured, to step into the shoes of its insured and to attempt to recover the amount it paid from a third party responsible for causing the loss.<sup>17</sup> This is what is known as a "**right of subrogation**", although the current standard form ISO property and CGL policies call this a "**transfer of rights of recovery**." Regardless of the words used in the applicable insurance policy, this right on the part of the insurer is often called "**conventional subrogation**" or "**contractual subrogation**" because it arises out of the contract of insurance between the insured and the insurer. It is generally the right implicated in a commercial lease where the lease obligates either the landlord or the tenant (or both) to carry insurance.

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There are two other types of subrogation, however, that might apply in any given situation.

The first of those two other types are known as “**equitable subrogation**” or “**legal subrogation**.” This type of subrogation right is not dependent on a contract. Instead, it arises by operation of law out of “fairness” or “equity” which is intended to do justice between the wronged party and the person who should have paid the debt or obligation. When contracting parties’ rights of recovery against each other, and their insurer’s rights of subrogation, are not spelled out in the contract, the insurer’s right to recover against a negligent person rests on common law. Because equitable or legal subrogation is a creature of the common law, whether a party has a right to equitable subrogation following its payment of a loss or damages on behalf of another party varies from jurisdiction to jurisdiction. As set out below, courts typically take one of three approaches when determining whether a lease party’s insurer has an equitable right of subrogation.

The second of the other two types of subrogation is “**statutory subrogation**,” which is set forth in statutory provisions, such as the workers compensation statutes in all states, and other types of medical expense recovery statutes. This paper will not address statutory subrogation, but the principles of equitable subrogation are sometimes relevant to the landlord-tenant contractual relationship where the lease at issue is silent on the point.<sup>18</sup>

**c. Waiver of Recovery by Protected Party**

The lease may contain a **release**<sup>19</sup> or **exculpation**<sup>20</sup> by a Protected Party, if the damage, loss, or injury is caused in whole or in part by the negligence of the other party or by its contractors or invitees. Release or exculpation lease provisions that relate to property damage provide that the party whose property is damaged releases or waives the right of recovery (a “**release of claims**”) against the other negligent party and that the Protected Party will look to the property insurance (which may be carried by either the landlord or the tenant, depending on what the lease provides) for recovery. Releases

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of claims can also apply to releases or exculpation for claims asserted against them with respect to bodily injury asserted by a third party under a premises liability type claim. While a release of claims also results in a waiver of subrogation (because the insurer has no rights left to which it can be subrogated), a waiver of subrogation (which is available to a party’s insurer) alone is not a release of claims against the other party that is available to the Protected Party.

**d. Waiver of Insurer’s Right of Subrogation**

Many property and liability insurance policies (but not all) allow the insured to prevent its insurer from exercising its contractual subrogation right **if** the insured waives its right to recover damages or losses caused by a third party from that third party (often called a “**waiver of subrogation**” but is really a release of claims) if the waiver (release) is in writing and generally only if it is made **prior** to the occurrence of the loss (*e.g.*, a contractual waiver of recovery and waiver of subrogation set out in the lease).<sup>21</sup> In addition, the ISO CP 00 90 07 88 Commercial Property Conditions (**Form 2** in the Appendix) also permits certain waivers to be made after a loss, including permitting an insured landlord to waive its right of recovery against a tenant for damage to its covered property or covered income **after** a loss.<sup>22</sup>

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The lease may contain a provision stating that the insurer will have no right of subrogation, or stated differently, the right of subrogation of the insurer is waived. Technically, the parties to a lease do not have the right to waive an insurer’s right of subrogation, as the insurer is not a party to the lease. However, courts have long confused the waiver of the right of subrogation with a release of the right of recovery, but the better approach (if waiver of subrogation is the objective) is for the parties to release their respective rights of recovery against each other, and their agents, employees and contractors, thereby essentially waiving the insurer’s rights of subrogation (or more correctly stated, nullifying the insurer’s right of recovery as against a potentially responsible third party).

The lease may also provide that the party obtaining the insurance will obtain an endorsement to the property policy whereby the insurer waives its rights of subrogation (*i.e.*, the right to recover) the insurance proceeds paid to its insured from the negligent party. As noted above, such an endorsement may not be necessary if the insureds' policies are the standard form ISO policies, but if either of the insured parties (the landlord or the tenant) have manuscripted or blanket policies written on a different form, such an endorsement may be necessary. Also, where the tenant will be entering into a contract for construction of tenant improvements, the contractor's insurance may not technically include a waiver of the right of recovery as against the landlord, as the landlord is not in privity of contract with the tenant's contractor.<sup>23</sup>

If an endorsement to the insurance policy is required in order to effectuate the waiver of subrogation provision in the lease, the lease may also require the Protecting Party to pay any additional cost or premium required to obtain that endorsement.<sup>24</sup> However, many insurers do not charge an additional premium (other than a nominal fee to issue the endorsement) for the increased risk to the insurer of the insured waiving recovery/subrogation.<sup>25</sup>

## II. COMMON LAW

If the lease is silent as to the insurer's right of subrogation to recoup the proceeds it has paid to cover the insured's property damage or liabilities, some courts may as a matter of the common law in the applicable jurisdiction either find that the insurer has no right of subrogation or has an equitable right of subrogation. In some states, such as **Florida, Illinois and Indiana**, there is no hard and fast rule and the court makes its determination as to whether the insurance company may enforce a right of subrogation on a **case-by-case basis**, based on the intent and reasonable expectations of the parties under the terms of the lease and the facts of the case. Given the differences among the states as to whether the insurance company has or doesn't have an equitable right of subrogation, the better practice is to address this issue in the lease.<sup>26</sup>

### A. Majority Rule: Implied Coinsured Status Negates Equitable Subrogation

#### 1. Landlord's Agreement to Obtain Property Insurance is for Both Parties' Benefit

A **majority** of courts follow a common law rule that a landlord's property insurer may not subrogate against a tenant whose negligence has caused damage to the landlord's property. These courts have found that the tenant is an **implied coinsured**.<sup>27</sup> These courts have concluded that the landlord's agreement to procure property insurance covering the building implies an obligation by the landlord to insure the building for the benefit of both the landlord and the tenant. This is the so-called "**Sutton Rule**" named after the case *Sutton v. Jondahl*, 532 P.2d 478 (Okla. Ct. App. 1975), which involved the lease of a home that was damaged by a fire caused by a mishap involving tenant's son's chemistry set and an electric popcorn popper the son was using to heat some chemicals. The court articulated the **rule** as follows (emphasis added):

Under the facts and circumstances in this record the subrogation should not be available to the insurance carrier because the law considers the tenant as a co-insured of the landlord absent an express agreement between them to the contrary, comparable to the permissive-user feature of automobile insurance. This principle is derived from a recognition of a relational reality, namely, that both landlord and tenant have an insurable interest in the rented premises—the former owns the fee and the latter has a possessory interest....

Basic equity and fundamental justice upon which the equitable doctrine of subrogation is established requires that when fire insurance is provided for a dwelling it protects the insurable interests of all joint owners including the possessory interests of a tenant absent an express agreement by the latter to the contrary. 532 P.2d at 482.

## 2. Tenant Impliedly Paid for Insurance

In the *Sutton* case, the court went on to state

as a matter of sound business practice the premium paid [by the landlord for the fire insurance policy it procured] had to be considered in establishing the rental rate on the rental unit. Such premium was chargeable against the rent as an overhead or operating expense. And of course, it follows then that the tenant actually paid the premium as part of the monthly rental. 532 P.2d at 482.

Other courts that have followed the so-called *Sutton Rule* have likewise reasoned that the tenant has indirectly paid for the insurance, either through rent or through an expense pass through.

### B. Case-by-Case Approach

In other cases, where the lease does not explicitly address the right of subrogation a number of courts have attempted to ascertain the intent of the parties as to whether the tenant should be considered a coinsured under the landlord's policy on a **case-by-case basis** by considering

the lease as a whole, the reasonable expectations of the parties, and the principles of equity and good conscience.

*Dix Mutual Ins. Co. v. LaFramboise*, 597 N.E.2d 622, 626, 149 Ill. 2d 314 (Ill. 1992) (lease of a farmhouse and farm).

**Illinois.** In the *Dix* case, the Illinois Supreme Court reviewed the provisions of the lease for a farm and farmhouse. (1) The lease clearly exempted the landlord from liability for damage to the tenant's personal property and provided the tenant assumed the risk with respect to its personal property. (2) Although the lease did not address property insurance on the leased premises at issue, the fact that the landlord was not liable for damage to the tenant's personal property and took out a fire insurance policy

covering the leased premises meant the parties intended each would be responsible for its own property, the tenant was not liable for fire damage to the premises, and the landlord would be obligated to look solely to its insurance as compensation. (3) Furthermore, the insurance company was prohibited from pursuing a subrogation claim against its own insured or any person or entity who has the status of a coinsured under the insurance policy. (4) Because the tenant was essentially paying for the landlord's insurance policy through his rent payments, the tenant gained the status of a coinsured under the landlord's insurance policy, and both parties "intended that policy would cover any fire damage to the premises no matter who caused it." *Id.* Accordingly, the landlord's insurance company was not permitted to maintain a subrogation action against the tenant. This same rule has been held applicable in Illinois to commercial leases in a number of cases.<sup>28</sup>

**California, Florida, Indiana.** California, Florida and Indiana also have employed the case-by-case approach.<sup>29</sup>

However, courts are more reluctant to recognize an implied waiver in the case of an insured tenant and a negligent landlord causing damage to tenant's property. The reason for the distinction is that there was no payment of the insurance through rent, no surrender clause applicability, and probably no reasonable expectation on the part of the landlord to be free from liability.<sup>30</sup>

### C. Minority Rule: No Implication of Co-Insured Status and No Waiver of Equitable Subrogation

**New York and Other Jurisdictions.** The minority rule (sometimes referred to as the "**Anti-Sutton Rule**") in a number of jurisdictions, including New York, is based on the **common-law presumption** that a tenant is liable for the tenant's own negligence and subject to the equitable principle of subrogation. Upon payment by the landlord's insurer for an insured property loss, the landlord's **insurer is subrogated** to the landlord's rights and claim against its tenant and can sue the tenant to recoup the insurance proceeds.<sup>31</sup> The covenant requiring

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the landlord to insure its own property is **not equivalent to a release of claims or a waiver of subrogation**.

**D. Covenant Requiring Tenant to Pay for Insurance and Name Landlord as an Insured Equivalent to Waiver of Recovery By Landlord Against Tenant**

In *Publix Theatres Corp. v. Powell*, 71 S.W.2d 237 (Tex. Comm. App. 1934), the tenant agreed in the lease to carry fire insurance on the leased building, at the tenant's expense, naming the landlord as the insured. After the theatre was completely destroyed by fire, the insurer paid, but the landlord still sued the tenant for the loss. The court declared that to permit the landlord to keep the insurance money and also to collect from the tenant would be to allow the landlord a double recovery, not allowed by law. *Id.* at 241.

**E. Exception for Casualty Loss to Return of Premises**

In *General Mills v. Goldman*, 184 F.2d 359 (8<sup>th</sup> Cir. 1949), General Mills leased an industrial plant from plaintiff, Harry Goldman. One of General Mills' employees negligently started a fire that destroyed the plant. The Landlord's insurance paid Goldman for his damages. Goldman sued General Mills claiming that his losses exceeded the insurance coverage. The insurance company intervened and claimed that it had a right of subrogation for the amount it had paid Goldman. The trial court found in favor of Goldman and the insurer. The court of appeals reversed on the basis of the return of premises provision which excepted "loss by fire." The majority of the court concluded that this provision was a waiver of recovery by the landlord against the tenant for the negligently caused fire.

After *Goldman*, a number of cases have found that the lack of a waiver of recovery in the return of premises provision permits the insurer to recover amounts paid to its insured by way of subrogation from the negligent party.<sup>32</sup>

For example, see *Cerny-Pickas & Co. v. C.R. Jahn Co.*, 131 N.E.2d 100, 7 Ill. 2d 393 (Ill.

1955), a case that involved the lease of a large industrial building and machinery and equipment located inside the building that was destroyed by fire that the jury found was due to the negligence of the tenant. The court also found the landlord and its insurer could not recover any of the loss from the tenant. The lease contained a provision that obligated the tenant to return the premises to the landlord upon termination of the lease in "good condition and repair (loss by fire and ordinary wear excepted)." 131 N.E.2d at 103. According to the court, if, as argued by the landlord and its insurer, the tenant remained liable in tort to the landlord and its insurer for the damage to the building despite the contractual waiver in the lease of the obligation to restore the premises if it was destroyed by fire, then it would be necessary for both the tenant and the landlord to carry insurance covering the building and the machinery and equipment, which the court speculated might not be commercially available. *Id.* In the lease at issue in the *Cerny-Pickas* case, the landlord agreed to insure the building, machinery and equipment, and the tenant was only obligated to pay any increase in the landlord's premiums for that insurance due to the nature of its business or how it was conducted. *Id.*

**F. Valid Despite Negligent Released Party**

In **Texas**, release of claims and waiver of subrogation clauses are valid if they satisfy certain drafting standards imposed by the court.<sup>33</sup> In order for indemnity and waiver provisions to be enforceable in Texas they must be drafted to comply with the two-pronged "fair notice doctrine" under Texas case law: **(1)** the "express negligence rule" set forth in *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987), and **(2)** the "conspicuousness rule" enunciated in *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993).

**G. Alternative - Both Parties as Named Insured?**

Sometimes in lieu of there being one named insured, the tact is taken to name both parties as named insured. This is a common and acceptable practice in builders risk insurance, with both the owner and contractor, or owner,

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tenant and contractor, and many times subcontractors named as insureds. This approach is also sometimes taken in property leases in lieu of a waiver of recovery with waiver of subrogation. The supporting principle is that an insurer may not subrogate against its insured. This approach has inherent (but not insurmountable) problems.<sup>34</sup>

### III. DRAFTING

#### A. Missing Provisions

##### 1. Waiver of Subrogation; But No Waiver of Recovery

A failure on the part of the parties to waive their rights of recovery as against each other while attempting to waive their insurer's rights of subrogation may result in an unintended consequence – remaining liable to each other for loss or damage that would otherwise be covered by insurance – a potential double recovery on the part of the injured party. Courts should deny double recovery on equitable grounds, but there is no certainty.

**Question:** What happens if the injured party elects not to pursue a claim against its insurer (in an attempt to keep its premiums to a lower level, if premiums are based in part on claims experience), but seeks recovery against the other party?

In the absence of a waiver of recovery, the party that negligently causes damage or injury to the other party could be exposed for the loss or damage (becoming an “unintended Protecting Party”).<sup>35</sup>

If the policy under which the unintended Protecting Party is an insured includes a typical “**other insurance clause**” and the other party is an additional insured under the insured's policy, then as a result, the unintended Protecting Party's policy will not cover amounts that would have been available under the other party's insurance.<sup>36</sup>

Avoiding any arguments along these lines would be best for both the landlord and the tenant.

##### 2. No Waiver of Recovery; and No Waiver of Subrogation

In circumstances where the lease does not contain a contractual release of claims or a contractual waiver of subrogation, or both, the insurer's right to recover against a person other than its insured rests on the common law principles of equitable subrogation and waiver of equitable subrogation.<sup>37</sup>

##### 3. Contractual Waiver of Subrogation; But No Waiver of Subrogation by Insurer and No Waiver of Recovery

An issue sometimes arises when the lease does not contain a waiver of recovery but contains a contractual requirement for the insuring party to obtain a waiver of subrogation, but the insuring party does not.<sup>38</sup>

**Practice Point:** Obtain acknowledgement from the insurer that it has waived subrogation.

#### B. Drafting Conflicting Provisions <sup>39</sup>

##### 1. Waiver of Claims vs. Return of Premises

A lease may be drafted to require the tenant at the termination of the lease to return the premises in the original condition, reasonable wear and tear and casualty loss excepted. See discussion of *General Mills v. Goldman*, 184 F.2d 359 (8<sup>th</sup> Cir. 1949) in this Article at II.E Common Law - Exception for Casualty Loss to Return of Premises.

Sometimes, this covenant is expanded though to except from the exclusion casualties occurring through a tenant's negligence.

**Return of Premises.** Tenant is to return the leased premises in its original condition **except** for reasonable wear and tear and damage by casualty not occurring through the **Tenant's negligence**.

Such a clause is potentially in conflict with the waiver of recovery/waiver of subrogation clause,

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unless specifically excepted in the waiver clause. It should be avoided from the tenant's point of view if it does not want to be responsible for repairing fire damage to the landlord's property caused by its own negligence or that of its employees, invitees or contractors.

## 2. Waiver of Recovery vs. Protecting Party's Negligence

The waiver of recovery may be drafted to exclude waiving recovery for loss caused by the Protecting Party's negligence.

**Waiver of Recovery.** Landlord releases Tenant from all claims for damage to Landlord's property, **except** if caused by **Tenant's negligence** or by the negligence of persons for whom Tenant is legally liable.

Another:

**Waiver of Recovery.** Landlord releases Tenant from all claims for damage to Landlord's property, **except** if caused by Tenant's **gross negligence** or by the negligence of persons for whom Tenant is legally liable.

A waiver so drafted misses the point of the waiver. The objective is to shift the risk away from the negligent party to the Protected Party's insurance company and to eliminate the subrogation right of the insurer of the Protected Party.

This clause may appear to be appropriate in light of the tenant's more general repair and maintenance obligations, but if that clause is not carefully drafted it could conflict with the waiver of recovery provision. As noted above, the tenant may not have any property insurance coverage under its CGL policy to cover damage to the leased premises caused by its negligence or that of its employees, officers or directors, or the amount of the coverage may be limited to a lesser sublimit amount than the full limits available for other types of claims.

Both parties benefit by avoiding disputes and litigation, including avoiding the adversarial

impact on the relationship, the time lost in depositions, record production and court hearings. Shifting the burden of loss to the non-negligent party's insurer may benefit the non-negligent party. For example, a landlord failing to waive recovery and subrogation can result in the landlord's insurer obtaining a potentially bankrupting judgment against the negligent tenant.

## 3. Waiver of Claims vs. Indemnity

The indemnity provision may be written so broadly that the Protecting Party's indemnity indemnifies the Protected Party for claims insured by the Protected Party's insurance and as to which there is a waiver of recovery in the lease. In such a lease the indemnity does not expressly exclude indemnification for damages or liabilities insured by the insurance program set up in the lease.

**Indemnity.** Tenant indemnifies Landlord against **any** claim, loss or cost arising from Tenant's use and occupancy of the premises.

**Insurance.** Landlord shall maintain insurance as it shall determine in its sole judgment.

### Questions:

- What is intended, recovery on the indemnity?
- Or recovery on the insurance?

The indemnity clause should be revised to specifically exclude indemnity where the parties intend that insurance is to be the source of protection, and this intent is reflected in the waiver of recovery and waiver of subrogation provisions. AIA approaches this conflict with the following language in AIA A201 General Conditions Paragraph 11.3.7 Waivers of Subrogation as follows:

... A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not

pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

#### 4. Damage Liability Covenant vs. Waiver of Claims and Insured Risk

Clauses that make the tenant liable for damages to the building should except damage to the extent insured by insurance intended by the parties to insure that property risk.

**Release of Claims/Subrogation.** Landlord and Tenant release each other and Lienholder and their Agents from all claims or liabilities for damage to the Premises or Shopping Center, damage to or loss of personal property within the Shopping Center, and the loss of business or revenues that are covered by the releasing party's property insurance or that would have been covered by the required insurance if the party fails to maintain the property coverages required by this Lease. <sup>40</sup>

It sounds sensible that a party should agree to be responsible for damages it causes to the other party's property; but only to the extent such damage is not insured by or for the Protected Party under the risk management provisions of the lease and such insurance is the intended funding mechanism.

**Release of Claims/Subrogation.** The release in this paragraph will apply even if the damage or loss is caused in whole or in part by the ordinary negligence or strict liability of the released party but will not apply to the extent the damage or loss is caused by the gross negligence or willful misconduct of the released party or its agents. <sup>41</sup>

#### Questions:

- What about deductibles and self-insured retentions?
- Does the above provision address who is responsible for these amounts?

**Release of Claims/Subrogation.** The party incurring the damage or loss will be responsible for any deductible or self-insured retention under the property insurance. <sup>42</sup>

#### Practice Points:

- Under-insured or inadequately-insured damages claims can result in unintended risk allocation to the Protecting Party (e.g., replacement cost vs. actual cash value; co-insurance; "all risk" insurance vs. causes of loss insurance; special causes of loss vs. basic causes of loss or broad causes of loss; special risks - windstorm, flood, hail).
- Landlord's property policy should be written to cover all improvements if they are landlord's property on termination of the lease. Tenant may seek to insure improvements, betterments and alterations paid for by tenant. Note tenant will only be paid the actual cash value of the destroyed improvements if it does not rebuild. If tenant wants to rebuild at a new location, it should be able to get replacement cost, if it meets its policy's requirements.

#### C. Deficiently Drafted Provisions

##### 1. Waiver of Claims Limited to "Covered" Claims

The lease may waive claims against a party (e.g., the tenant) for that party's negligently caused damage to the other party's (e.g., the landlord's) property to the extent the damage is "**covered**" by the damaged party's insurance. Either the Party to be Protected or the Protecting Party may be the party required by the lease to carry the insurance. If the Party to be Protected is purchasing the insurance, it is also the Protecting Party.

**Waiver of Recovery.** Landlord and Tenant release each other for damage to the Premises or Shopping Center, damage to

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personal property within the Shopping Center that are **covered** by the insurance required by this Lease.

**Questions:**

- Does “covered” mean “covered if insured” by insurance?
- What if the Protected Party is to purchase the insurance, but does not? In this case the waiver is meaningless.
- Does “covered” mean the insurance specified in the lease to be obtained by the Party to be Protected?
- What if the lease requires insurance to be carried by the landlord but does not specify in detail the insurance to be obtained?
- What if the insurance specified in the lease, even if obtained, does not cover or adequately cover the damage or liability?
- Does “covered” mean insurance that have covered the loss had adequate insurance been obtained?

What if the waiver of claims is as to claims, "coverable by insurance"?

**Waiver of Recovery.** Landlord and Tenant release each other for damage to the Premises or Shopping Center, damage to personal property within the Shopping Center that are **covered or coverable** by insurance.

It may be possible for a price to purchase insurance broader than ISO "special causes of loss" coverage.<sup>43</sup> Have the parties waive recourse against the other for claims broader than what is available under standard insurance? Should they?

**2. Waiver of Claims vs. “Available Insurance” or “Collected Proceeds”**

The Protecting Party may be left exposed to uninsured loss if the waiver of recovery is limited to the Protected Party waiving recovery as to “**available insurance**” or “**collected proceeds**” and the insurance specifications and the resultant insurance maintained under the lease does not fully insure the liability or loss.

**Waiver of Subrogation.** Landlord and Tenant release each other ... to the extent of **available insurance** ...

**Questions:**

- See questions above as to “covered” claims.
- Who covers deductibles or self-insured retentions or excess loss?

**3. Tenant Indemnity vs. Landlord Property Insurance**

**Indemnity.** Tenant indemnifies Landlord against **any** claim, loss or cost arising from Tenant’s use and occupancy of the premises.

**Insurance Specification.** Landlord shall maintain property insurance in the amount of the replacement cost of the Property. Landlord is to obtain a waiver of subrogation from its insurer.

- **Question:** What is intended, recovery on the indemnity? or recovery on the insurance?

**4. Covenant to Obtain Waiver of Insurer’s Right of Subrogation, But Policy Does Not Permit**

**Scenario 1:** Landlord covenants to maintain property insurance on the Property. Lease does not contain a waiver of recovery or a covenant to obtain a waiver of subrogation from landlord’s insurer. Landlord’s insurer uses a non-ISO policy form that does not permit pre-loss or post-loss waivers of subrogation. Landlord’s insurer pays Landlord for the loss. Tenant’s negligence caused the loss.

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**[Waiver of Recovery. No provision in the lease.]**

**Insurance Specification.** **Landlord** shall maintain property insurance in the amount of the replacement cost of the Shopping Center including the Premises.

**Insurance Policy.** If any person or organization to or for whom we make payment under this coverage part has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing after loss to impair them.

**Questions:**

- Oops; now what? Landlord's insurer subrogates against Tenant?
- Should have included a waiver of recovery?
- Would a waiver of recovery invalidate the landlord's insurance coverage?

**Scenario 2:** Landlord's property insurance is issued on an **ISO CP 00 90 07 88 Commercial Property Conditions**; and the Lease either does or does not have a waiver of recovery by landlord against tenant.

**Insurance Policy.** ... **[ISO CP 00 90 07 88 Commercial Property Conditions.** See Form 2 in Appendix of Forms].

ISO CP 00 90 07 088 contains pre-approval for the landlord to contractually waive insurer's subrogation, both before and after loss.

**Scenario 3.** Tenant insures the loss, and the Insurance Specification and Insurance Policy is the ISO property insurance form. The loss is caused by landlord's negligence. The lease either does or does not have a waiver of recovery by tenant against landlord.

**Insurance Specification.** **Tenant** shall maintain property insurance in the amount of the replacement cost of the Property. Tenant shall maintain property insurance in the amount of the replacement cost of the Property.

**Insurance Policy.** ... **[CP 00 90 07 88 Commercial Property Conditions.** See Form 2 in Appendix of Forms].

The ISO form does not permit post-loss waiver by a tenant but would have permitted a pre-loss waiver to be contained in the lease. Tenant's insurer pays for the loss and collects from landlord in subrogation to tenant's right of recovery.

**5. Waiver of Recovery and Subrogation Not Expanded to Derivative Persons**

Consideration should be given to expanding the waiver of recovery and waiver of subrogation to expressly include waivers as to persons derivative of landlord or tenant, rather than limiting the waivers only to persons named.

**Mutual Waiver of Recovery; Waiver of Subrogation.** Landlord and Tenant release each other [also add: **and their respective officers, directors, shareholders, members, employees, successors and assigns, and assignor after assignment**] ... and will notify the issuing insurance company of the release .... and will have the insurance policies endorsed, if necessary, to prevent invalidation of coverage. This release will not apply if it invalidates the insurance coverage of the releasing party.

In *Interstate Fire Ins. Co. v. First Tape, Inc.*, 817 S.W.2d 142 (Tex. App.— Houston [1st Dist.] 1991, writ denied), the court of appeals refused to limit the waiver of subrogation contained in the lease to claims against the current tenant so as to permit the otherwise subrogated insurer to pursue the former tenant after assignment. The assigning tenant, First Tape, therefore, was able to retain the protection of the waiver of subrogation clause even after it had assigned its lease.

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**6. Overly Broad Indemnity May Invalidate Entire Indemnity Provision**

As noted in Part I.C.3.a. above, a landlord in Illinois cannot be indemnified by a tenant against its own negligence, and any provision in a lease that purports to exempt the landlord for its own negligence, or that of its “agents, servant or employees” is “void and against public policy and wholly unenforceable.” 765 ILCS 705/1(a). On its face, the language in the statute might appear to address “exculpatory” provisions (*i.e.*, those that seek to relieve landlords from their own negligence (or that of their agents, servants or employees)) rather than “indemnity” provisions. However, the statute was applied to a void an entire lease indemnity provision in *Economy Mechanical Industries, Inc. v. T.J. Higgins Co.*, 689 N.E.2d 199, 294 Ill. App. 3d 150, 228 Ill. Dec. 327 (1<sup>st</sup> Dist. App. 1997). The lease provision, which was from a familiar form used by a number of smaller landlords in Illinois at that time, read as follows:

**Lease:**

Lessee covenants and agrees that he will protect and save and keep the Lessor forever harmless and indemnified against and from any penalty or damages or charges imposed for any violation of any laws or ordinances, whether occasioned by the neglect of Lessee or those holding under Lessee, and that **Lessee will at all times protect, indemnify and save and keep harmless the Lessor against and from any and all loss, cost, damage or expense, arising out of or from any accident or other occurrence on or about the Premises, causing injury to any person or property whomsoever or whatsoever** and will protect, indemnify and save and keep harmless the Lessor against and from any and all claims and against and from any and all loss, costs, damage or expense arising out of any failure of Lessee in any respect to comply with and perform all the requirements and provisions hereof.

Relying on an earlier Illinois case, the *Economy* court held that the statute also prohibited a lease clause that sought to indemnify the landlord for

its own negligence. According to the court, the lease clause in question was sufficiently broad to include indemnification for the landlord’s own negligence and was therefore void for all purposes and could not be enforced. 689 N.E.2d at 203.

What is most troubling about the *Economy* case for drafters of Illinois leases is that it involved a claim for indemnification brought by the landlord arising out of a suit by one of the landlord’s employees who was injured while on the leased premises. According to the opinion, the complaint did not contain any detail on how the employee was injured or whose negligence caused the employee’s injury. However, the court found it was not important as to whether the landlord was seeking to be indemnified for its own negligence or that of the tenant. *Id.* As a result of this case and the earlier one relied upon by the *Economy* court, landlords in Illinois have had to make certain the exculpatory and indemnification provision in their leases specifically provide they are not intended to exculpate or indemnify the landlord against its own negligence or that of the landlord’s agents, servants or employees.

Later cases in Illinois have drawn a distinction between an agreement to indemnify a landlord for its own negligence, which would be void in Illinois, and an agreement to insure or provide insurance for the benefit of the landlord, such as by naming the landlord as an additional insured on the tenant’s CGL policy. Such agreements are enforceable in Illinois,<sup>44</sup> although, as discussed below in Part IV.C., there still may be problems and issues lurking in those clauses.

After the *Economy* case was decided, the Illinois statute was amended to specifically allow a landlord under a non-residential lease to be exempted from liability for property damage. *See* 765 ILCS 705/1(b). Accordingly, provisions in a commercial lease that exempt or exculpate the landlord for liability for damage to the tenant’s personal property are not void in Illinois.

**IV. SELF-INSURANCE IS NOT INSURANCE**

### A. What is Self-Insurance?

“Self-insurance” is not insurance.<sup>45</sup> Self-insurance is nothing more than a risk retention device (a method of “financing” certain risks), and an indemnity by the “self-insurer”, the indemnifying party. Self-insurance and large self-insured retentions are a popular method for financing certain risks, particularly among very large commercial businesses<sup>46</sup> and public entities.<sup>47</sup> Self-insurance has the benefit of retaining dollars otherwise payable for insurance for cash flow purposes until needed to pay claims.

The term “self-insurance” is used to describe a range of risk retentions by the self-insurer. Self-insurance can range from no insurance (“**going bare**”), to a policy deductible, to insurance purchased over a large self-insured retention (“**SIR**”). An SIR is sometimes referred to as a “**retained limit**”.<sup>48</sup> In the case of a deductible or SIR it may be designated as a dollar amount or a percentage. A deductible or SIR is the monetary threshold that must be met before the insurer is obligated to pay liabilities or losses covered by the policy.

### B. Self-Insurance Specification Drafting

If self-insurance is to be considered, consideration should be given to establishing financial means tests and monitoring procedures. Unless the parties have established a restricted and encumbered fund or a reinsurance program, all that you have is the unsecured indemnity of self-insurer. The term “self-insurance” does not, without further detail, specify what procedures are to be followed and what protection is available.

A self-insurance right should be limited to the named entity and care should be addressed in the permitted assignment or successor provisions so as to avoid assignment or succession by entities of lesser credit worthiness.

### C. Self-Insurance and Additional Insured Status

Being named as an “additional insured” on a self-insurance program, does not provide any

additional insurance to the “additional insured”, as the indemnitor is the sole funding entity.<sup>49</sup>

### D. The Self-Insured Landlord

In the self-insurance context, parties sometimes use the term “waiver of subrogation,” but in reality what is meant is a “**waiver of recovery**,” the self-insured is waiving its right of recovery as to the other party. A self-insuring property owner may balk at waiving its right of recovery. However, when an owner elects to self-insure it likely has done so for sound economic reasons. By waiving recovery (aka granting a waiver of subrogation) against the other party, the waiving party assumes the risk of loss due to the negligence of the other party. If this waiver is not granted, then the other party might condition doing the transaction on its obtaining property insurance covering the loss, and seeking to pass the premium cost back to the other party. For example, a contractor contracting with a self-insured owner, who does not waive recovery against the contractor, likely will pass the insurance cost back to the self-insuring owner, and will seek to limit its liability to collected insurance proceeds.

### E. The Self-Insured Tenant

If an owner permits its tenant to self-insure losses to its building, in addition to the financial security concerns noted above, the lease should address the following concerns. Like an insurer, the self-insured tenant should be required to produce a “**certificate of self-insurance**” to the landlord and its mortgagee specifying the type of casualty coverage (*e.g.*, replacement cost with agreed value endorsement), the amount thereof and policy terms. The self-insurance coverage should name the mortgagee under a standard mortgagee clause providing that the mortgagee is not subject to defenses to coverage that the tenant may otherwise have with respect to payment. Of course, the self-insurance concept needs to be approved by the owner’s mortgagee. The self-insured tenant will need to confirm to the owner and its mortgagee that it has waived its right of recovery (subrogation) against the landlord. If the casualty loss may result in lease termination, the lease should address disposition of “**self-insurance proceeds**,” for example, requiring the self-insured tenant to deposit an

amount equal to the insurance proceeds otherwise payable to the landlord under the terms of a property insurance policy that was to have been maintained absent self-insurance. The self-insurance provision should address rent loss coverage, while the premises are being restored.

**V. BEST PRACTICE TIPS**

The following are best practice tips.

**A. Drafting.<sup>50</sup>**

**1. Clear Language**

Waivers are accomplished by clear language in the lease, clearly stating that the Protected Party (Protected Parties if a mutual waiver) (1) waives recovery against the other party, specifying the liabilities and loss covered by the waiver, and (2) will obtain confirmation from the insurer that the insurer waives the insurer’s right of subrogation.

**2. Mutuality**

In almost every case the waivers of subrogation should be mutual.<sup>51</sup>

**3. Requirement to Maintain Insurance Sufficient to Insure the Loss or Liability**

If the waiver of recovery is limited to “available proceeds”, “collected proceeds”, or “covered claims”, it is especially important that the insurance required under the lease sufficiently insure the loss or liability. Otherwise, suit for uninsured and underinsured losses and liabilities may result.

**4. Waiver of Subrogation as to All Insurance**

As noted by one imminent commentator, the release of claims should extend to the amount of insurance required under the lease, and the waiver of subrogation should extend to losses from insurance maintained by the Protected Party.

If the mutual release clause is concerned solely with insurance

required to be carried, the insurance company would still have the right of subrogation under these circumstances. To plug this gap, a lease needs a release between the parties as to perils covered by insurance required to be carried, and a waiver of subrogation as to perils covered by insurance actually carried.<sup>52</sup>

The following example was provided by a commentator:

For example, if the lease requires a policy of \$100,000, but the policy actually obtained was worth \$150,000, in the event of a fire causing damage in the amount of \$120,000, if the mutual release clause applies only to the amount of required insurance, the insurance company could still be able to be subrogated to the rights of the insured for \$20,000. In order to avoid this result, the release should apply to the amount required to be carried (\$100,000), and the waiver of subrogation should apply to the amount actually carried (\$150,000), or the greater of the two.<sup>53</sup>

**5. Extent of the Waiver**

The waiver of recovery should be limited to “collectable” insurance proceeds as opposed to “collected” proceeds to avoid the case where the insured does not seek collection, but seeks recovery from the other party. Further, the waiver should extend beyond the landlord and tenant, but should also include partners, members, managers, shareholders, directors, officers, employees, subtenants and agents.

**6. Exclusion of Willful Misconduct**

Include in the waiver of recovery an exclusion for willful misconduct. Willful misconduct may invalidate a policy carried by the negligent party resulting in no protection for the Protected Party.

**7. Self-Insurance and Deductibles**

**Questions:**

- What if the party providing the insurance has a large deductible?
- What if the Protecting Party is self-insured?

The Protecting Party determines the amount of the deductible it will carry and whether it will self-insure the risk. If the waiver of recovery is limited to “available insurance” or “required insurance” issues exist as to the intent of the parties. The waiver of recovery should be drafted to address, the Protected Party’s right to recover beyond insurance.

**B. Review Subrogation Rights Provisions in the Insurance Policy**

**1. ISO Property Policy**

**a. Pre-Loss Waiver Permitted**

The ISO property policy for leased premises allows the parties to waive the insurer’s rights in advance by a waiver of claims in the lease. See ISO Commercial Property Conditions ¶ I. Transfer of Rights of Recovery Against Others To Us as Form 2 of the **Appendix of Forms**.

**b. Post-Loss Waiver by Landlord Permitted**

The ISO property policy also allows the landlord to waive the insurer’s subrogation right as against the landlord’s tenant even after a loss. See ISO Commercial Property Conditions ¶ I. Transfer of Rights of Recovery Against Others To Us in Form 2 of the **Appendix of Forms**. Note that this provision would not apply to subrogation claims against third parties and the term “**tenant**” is not defined, so the question remains as to whether the post-event waiver by the landlord would cover the negligence or intentional acts of a tenant’s officers, directors, or employees, and even agents or subtenants. Thus, from the tenant’s perspective, it is better to have a broad waiver in the lease.

**2. Non-ISO Property Policies**

Since there is no recognized standard property policy form, like the ISO liability form, it is

prudent to examine the property policy in connection with drafting the lease and to condition the lease, if necessary, on obtaining a subrogation waiver from the insurer. What is needed is an agreement of the insurer to waive any right of subrogation and confirming that the waiver of claims does not impair the insurance provided by the insurer. This is “doubly” true if there is a mutual waiver of claims in the lease.

**C. Importance of Reviewing Insurance Policies Against Indemnification Obligations**

Two other Illinois cases deserves mention as it demonstrates how seemingly “standard” insurance and indemnity provisions, or ones presented to a party to a lease by the other party, need to be carefully considered before agreeing to them. Clients often are not interested in such clauses, as they view them as “boilerplate” and do not want to critically consider the implications.

The cases, which were two appeals in the same case, are *Sears, Roebuck and Co. v. Charwil Associates Ltd. Partnership*, 864 N.E.2d 869, 371 Ill. App. 3d 1071 (1<sup>st</sup> Dist. 2007) and *Sears, Roebuck and Co. v. Charwil Associates Ltd. Partnership*, 793 N.E.2d 736, 342 Ill. App. 3d 167 (1<sup>st</sup> Dist. 2003). They did not involve an insurer’s subrogation claim. Rather, they involved a claim for indemnification asserted by a tenant of a shopping center (Sears) against its landlord, based on the provisions of the lease.

The lease provisions at issue (with pertinent provisions highlighted) read as follows (emphasis added):

**Landlord’s Insurance.**

Landlord will obtain and maintain or cause to be obtained and maintained, at all times . . . throughout the Term, the following insurance with companies approved by Tenant and containing standard provisions. .. (b) *Comprehensive General Liability Insurance*<sup>54</sup> . . . Including, but not limited to, coverage for Personal Injuries with limits of not less than Five

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Million Dollars (\$5,000,000) combined single limit for bodily injury and property damage, per occurrence, including Tenant as a named insured.

**Landlord's Common Area Indemnity.**

Landlord agrees to be responsible for, indemnify Tenant, its directors, officers, agents and employees, against, and save Tenant, its directors, officers, agents and employees harmless from, all liability from **any and all** damages, claims or demands that may arise from or be occasioned by the condition, use or occupancy of all Common Areas on the Entire Tract by the customers, invitees, licensees and employees of Landlord, Tenant and Landlord's other tenants and all other occupants on the Entire Tract, and Landlord will defend Tenant against any such claim or demand and reimburse Tenant for any cost incurred in connection therewith, including reasonable attorneys' fees. Landlord will obtain and maintain in a reputable insurance company or companies qualified to do business in the City of St. Charles, County of Kane, State of Illinois, liability insurance having limits for bodily injury or death of not less than Two Million Dollars (\$2,000,000.00) for each person, Five Million Dollars (\$5,000,000.00) for each occurrence and Two Hundred Fifty Thousand Dollars (\$250,000.00) for property damage, and insuring the indemnity agreement. Tenant shall be named insured, on this policy. Further, each policy will expressly provide that it will not be subject to cancellation or material change without at least thirty (30) days prior written notice to Tenant. Landlord will furnish Tenant, concurrently with the execution of this lease, with insurance certificates and upon request by Tenant, copies of such policies required to be maintained hereunder.

Prior to filing its claim against the landlord and its primary and excess insurance carriers, Sears

had been sued by a customer who had been severely injured when she was struck by another customer's vehicle being backed out of a Sears automotive service bay by a Sears' employee. Sears settled the case for \$17,250,000 and then sued the landlord of the shopping center under the above indemnity provision. The landlord had procured a CGL insurance policy with limits of \$1 million for each occurrence and \$2 million in the aggregate naming Sears as an insured and a \$25 million excess policy from a different insurer.

In the earlier of the two opinions, the court found that while the landlord did procure CGL insurance in the amounts required under the lease, the incident was not covered by the policy because of an exclusion in the policy for

"Bodily injury" or "property damage" arising out of the ownership, maintenance, use or entrustment to others of any aircraft, "**auto**" or watercraft owned or operated by or rented or loaned to any insured. 793 N.E.2d at 739.

Nevertheless, in its later opinion, the court held that the "**any and all**" language of the lease clearly intended for the Landlord to obtain insurance that would cover all liability from any claims that arose from a customer's use of the common areas. "If the parties had intended otherwise, they could have provided exclusions in the lease to limit insurance coverage." 864 N.E.2d at 874.

The court went on to affirm the trial court's determination that the Landlord breached its obligation to obtain insurance that would cover the pedestrian's claim but that Sears' recovery on account of the Landlord's breach was limited to \$2,000,000. Why? Because the Landlord's obligation to insure the indemnity it gave Sears was only for claims up to \$2,000,000.

**Lessons Learned:** What are the lessons to be learned here for landlords and for attorneys representing both parties?

- Landlords must avoid uninsured losses by refusing to indemnify their tenants

for injuries or claims arising out of the negligence of their tenants or their respective employees, officers and directors even if the claim arises out of an incident in the common areas of a shopping center or other multi-tenant building. Sears overreached in demanding an indemnity from the landlord for bodily injury caused by its own employee.

- Lawyers representing either party should carve out from an indemnity any bodily injury or property damage caused by the negligence of the other party, particularly now that the ISO Form Additional Insured endorsements almost uniformly exclude coverage for bodily injury, property damage or personal and advertising injury to third parties caused by the additional insured or anyone acting on behalf of the additional insured.<sup>55</sup>

## VI. CONCLUSION

It is clear from the materials covered in this paper that the issues surrounding releases, indemnification and waivers of subrogation rights on behalf of insurance companies cannot be treated as boilerplate with **one shoe fitting every circumstance**. The parties need to determine who should bear a particular risk, who is best suited to obtain the necessary insurance to minimize the parties' personal exposure to losses, and what amounts are appropriate given the nature of the property and the operations to be conducted at the property. Then, they should be sure their insurance brokers review the provisions drafted by the parties and determine whether and to what extent the indemnification obligations will be covered by the parties' insurance. There will be losses that cannot be insured, but to be fair, the objective ought to be to have the party that causes those losses bear the cost of those uninsured losses.

APPENDIX OF FORMS

**1. Texas Real Estate Forms Manual Retail Lease**

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The following provisions are contained in the Retail Lease form in the Texas Real Estate Forms Manual, a project of the Real Estate Forms Committee of the State Bar of Texas. TEXAS REAL ESTATE FORMS MANUAL, Chapter 25 Leases (3<sup>rd</sup> Ed. 1/2020) (emphasis added by authors). The waiver of recovery/waiver of subrogation is Section D.4. The Insurance Addendum is an exhibit to the lease and follows the form below. The following forms are copyrighted by the State Bar of Texas.

**RETAIL LEASE <sup>56</sup>**

**Basic Information**

...

Premises:

Approximate square feet: \_\_\_\_\_ sq. ft.  
Name of Shopping Center: \_\_\_\_\_  
Street address/suite: \_\_\_\_\_  
City, state, zip: \_\_\_\_\_

...

Tenant's Rebuilding Obligations: If the Premises are damaged by fire or other elements, Tenant will be responsible for repairing or rebuilding the following leasehold improvements: \_\_\_\_\_.<sup>57</sup>

**A. Definitions**

...

A.1. "Agent" means agents, contractors, employees, licensees, and to the extent under the control of principal, invitees.<sup>58</sup>

A.2. "CAM Charge" means the reasonable cost of ownership, operation, and maintenance of the Common Areas.

A.3. "Common Areas" means all facilities and areas of the Shopping Center that are intended and designated by Landlord from time to time for the common, general, and nonexclusive use of all tenants of the [Shopping Center/Building], including parking lots. Landlord has the exclusive control over and right to manage the Common Areas.

...

A.6. "Injury" means (a) harm to or impairment or loss of property or its use, (b) harm to or death of a person, or (c) "personal and advertising injury" as defined in the form of liability insurance Tenant is required to maintain.<sup>59</sup>

...

A.9. "Taxes and Insurance" means all ad valorem taxes and all insurance costs incurred by Landlord with respect to the Shopping Center.

**B. Tenant's Obligations**

**B.1. Tenant agrees to—**

...

B.1.f. Pay Tenant's Pro Rata Share of the monthly CAM Charge and monthly Taxes and Insurance ....

B.1.k. Repair, replace, and maintain any part of the Premises that Landlord is not obligated to repair, replace, or maintain, normal wear excepted.<sup>60</sup>

*B.1.g.*<sup>61</sup> INDEMNIFY, DEFEND, AND HOLD LANDLORD AND LIENHOLDER, AND THEIR RESPECTIVE AGENTS, HARMLESS FROM ANY INJURY (AND ANY RESULTING OR RELATED CLAIM, ACTION, LOSS, LIABILITY, OR REASONABLE EXPENSE, INCLUDING ATTORNEY’S FEES AND OTHER FEES AND COURT AND OTHER COSTS) OCCURRING<sup>62</sup> IN ANY PORTION OF THE PREMISES<sup>63</sup> IF CAUSED IN WHOLE OR IN PART BY THE ACTS OR OMISSIONS OF TENANT OR ITS AGENTS, INCLUDING IN WHOLE OR IN PART BY THE NEGLIGENT ACTS OR OMISSIONS OF TENANT OR ITS AGENTS. THE INDEMNITY CONTAINED IN THIS PARAGRAPH (i) IS INDEPENDENT OF TENANT’S INSURANCE,<sup>64</sup> (ii) WILL NOT BE LIMITED BY COMPARATIVE NEGLIGENCE STATUTES OR DAMAGES PAID UNDER THE WORKERS’ COMPENSATION ACT<sup>65</sup> OR SIMILAR EMPLOYEE BENEFIT ACTS,<sup>66</sup> (iii) WILL SURVIVE THE END OF THE TERM, AND (iv) WILL APPLY EVEN IF AN INJURY IS CAUSED IN PART<sup>67</sup> BY THE ORDINARY NEGLIGENCE<sup>68</sup> OR STRICT LIABILITY OF LANDLORD BUT WILL NOT APPLY<sup>69</sup> TO THE EXTENT AN INJURY IS CAUSED IN WHOLE OR IN PART BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF LANDLORD, LIENHOLDER AND THEIR RESPECTIVE AGENTS.<sup>70</sup>

...  
*B.2. Tenant agrees not to—*

...  
*B.2.a.* Use the Premises in any way that would increase insurance premiums or void insurance on the Shopping Center.

...  
**C. Landlord’s Obligations**

*C.1. Landlord agrees to—*

...  
*C.1.d.* Repair, replace, and maintain the (i) roof, (ii) foundation, (iii) Common Areas, and (iv) structural soundness of the exterior walls, excluding windows, store fronts, and doors.<sup>71</sup>

...  
*C.1.f.*<sup>72</sup> INDEMNIFY, DEFEND, AND HOLD TENANT<sup>73</sup> HARMLESS FROM ANY INJURY AND ANY RESULTING OR RELATED CLAIM, ACTION, LOSS, LIABILITY, OR REASONABLE EXPENSE, INCLUDING ATTORNEY’S FEES AND OTHER FEES AND COURT AND OTHER COSTS, OCCURRING IN ANY PORTION OF THE COMMON AREAS. THE INDEMNITY CONTAINED IN THIS PARAGRAPH (i) IS INDEPENDENT OF LANDLORD’S INSURANCE, (ii) WILL NOT BE LIMITED BY COMPARATIVE NEGLIGENCE STATUTES OR DAMAGES PAID UNDER THE WORKERS’ COMPENSATION ACT OR SIMILAR EMPLOYEE BENEFIT ACTS, (iii) WILL SURVIVE THE END OF THE TERM, AND (iv) WILL APPLY IF CAUSED IN PART BY THE ORDINARY NEGLIGENCE OR STRICT LIABILITY OF TENANT BUT WILL NOT APPLY TO THE EXTENT AN INJURY IS CAUSED IN WHOLE OR IN PART BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF TENANT.<sup>74</sup>

...  
**D. General Provisions - Landlord and Tenant agree to the following:**

*D.1. Alterations.* Any physical additions or improvements to the Premises made by Tenant will become the property of Landlord.<sup>75</sup> Landlord may require that Tenant, at the end of the Term and at Tenant’s expense, remove any physical additions and improvements, repair any alterations, and restore the Premises to the condition existing at the Commencement Date, normal wear excepted.<sup>76</sup>

*D.2. Abatement.* Tenant’s covenant to pay Rent and Landlord’s covenants are independent. Except as otherwise provided, Tenant will not be entitled to abate Rent for any reason.<sup>77</sup>

*D.3. Insurance.* Tenant and Landlord will maintain the respective insurance coverages described in the attached Insurance Addendum.

*D.4 Release of Claims<sup>78</sup>/ Subrogation.<sup>79</sup>* LANDLORD AND TENANT RELEASE EACH OTHER AND LIENHOLDER, AND THEIR RESPECTIVE AGENTS,<sup>80</sup> FROM ALL CLAIMS OR LIABILITIES FOR DAMAGE TO THE PREMISES OR SHOPPING CENTER, DAMAGE TO OR LOSS OF PERSONAL PROPERTY WITHIN THE SHOPPING CENTER, AND LOSS OF BUSINESS OR REVENUES THAT ARE INSURED BY THE RELEASING PARTY'S PROPERTY INSURANCE<sup>81</sup> OR THAT WOULD HAVE BEEN INSURED BY THE REQUIRED INSURANCE IF THE PARTY FAILS TO MAINTAIN THE PROPERTY COVERAGES REQUIRED BY THIS LEASE. THE PARTY INCURRING THE DAMAGE OR LOSS WILL BE RESPONSIBLE FOR ANY DEDUCTIBLE OR SELF-INSURED RETENTION UNDER ITS PROPERTY INSURANCE. LANDLORD AND TENANT WILL NOTIFY THE ISSUING PROPERTY INSURANCE COMPANIES OF THE RELEASE SET FORTH IN THIS PARAGRAPH AND WILL HAVE THE PROPERTY INSURANCE POLICIES ENDORSED, IF NECESSARY, TO PREVENT INVALIDATION OF COVERAGE.<sup>82</sup> THIS RELEASE WILL NOT APPLY IF IT INVALIDATES THE PROPERTY INSURANCE COVERAGE OF THE RELEASING PARTY. **THE RELEASE IN THIS PARAGRAPH WILL APPLY EVEN IF THE DAMAGE OR LOSS IS CAUSED IN WHOLE OR IN PART BY THE ORDINARY NEGLIGENCE OR STRICT LIABILITY OF THE RELEASED PARTY OR ITS AGENTS BUT WILL NOT APPLY TO THE EXTENT THE DAMAGE OR LOSS IS CAUSED IN WHOLE OR IN PART BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE RELEASED PARTY OR ITS AGENTS.**<sup>83</sup>

*D.5. Casualty/Total or Partial Destruction*<sup>84</sup>

*D.5.a.* If the Premises are damaged by casualty and can be restored within ninety days, Landlord will, at its expense, restore the roof, foundation, Common Areas, and structural soundness of the exterior walls of the Premises and any leasehold improvements within the Premises that are not within Tenant's Rebuilding Obligations to substantially the same condition that existed before the casualty and Tenant will, at its expense, be responsible for replacing any of its damaged furniture, fixtures, and personal property and performing Tenant's Rebuilding Obligations. If Landlord fails to complete the portion of the restoration for which Landlord is responsible within ninety days from the date of written notification by Tenant to Landlord of the casualty, Tenant may terminate this lease by written notice delivered to Landlord before Landlord completes Landlord's restoration obligations.

*D.5.b.* If Landlord cannot complete the portion of the restoration for which Landlord is responsible within ninety days, Landlord has an option to restore the Premises. If Landlord chooses not to restore, this lease will terminate. If Landlord chooses to restore, Landlord will notify Tenant in writing of the estimated time to restore and give Tenant an option to terminate this lease by notifying Landlord in writing within ten days from receipt of Landlord's estimate. If Tenant does not notify Landlord timely of Tenant's election to terminate this lease, the lease will continue and Landlord will restore the Premises as provided in D.5.a above.

*D.5.c.* To the extent the Premises are untenantable after the casualty, the Rent will be adjusted as may be fair and reasonable.<sup>85</sup>

**Insurance Addendum to Lease <sup>86</sup>**

Lease

Date:

Landlord:

Tenant:

This insurance addendum is part of the lease.

**A. Tenant agrees to—**

1. Maintain the property and/or liability insurance policies<sup>87</sup> **required** below (mark applicable boxes) and such other insurance coverages and/or higher policy limits as may be required by Lienholder during the Term and any period before or after the Term when Tenant is present on the Premises:

**Type of Insurance or Endorsement**

**Minimum Policy or Endorsement Limit**

*General Liability Insurance Policies Required of Tenant:*

<input type="checkbox"/>	Commercial general liability	Each occurrence:	\$ _____
		General aggregate:	\$ _____

*Or*

<input type="checkbox"/>	Business owner's policy	Each occurrence:	\$ _____
		General aggregate:	\$ _____

*Required Endorsements to Tenant's General Liability or Business Owner's Policy:*

<input type="checkbox"/>	Designated location(s) general aggregate limit	\$ _____
<input type="checkbox"/>	_____	\$ _____



*Additional Liability Insurance Policies Required of Tenant:*

<input type="checkbox"/>	Worker's compensation	Statutory limit
<input type="checkbox"/>	Employer's liability	\$ _____ each accident for bodily injury by accident/each employee for bodily injury by disease/bodily injury by disease for entire policy

- Business auto liability \$ \_\_\_\_\_
- Excess liability \$ \_\_\_\_\_
- Or*
- Umbrella liability \$ \_\_\_\_\_  
(occurrence basis)

*Property Insurance Policy Required of Tenant:*

- Commercial property insurance written on a causes of loss—special form (formerly known as “all risks” form) 100 percent of replacement cost of (a) all items included in the definition of Tenant’s Rebuilding Obligations and (b) all of Tenant’s furniture, fixtures, equipment, and other business personal property located in the Premises

*Or*

- Business owner’s policy 100 percent of replacement cost of (a) all items included in the definition of Tenant’s Rebuilding Obligations and (b) all of Tenant’s furniture, fixtures, equipment, and other business personal property located in the Premises

*Required Endorsements to Tenant’s Causes of Loss—[Special Form/Business Owner’s] Policy:*

- Business income and additional expense Sufficient limits to address reasonably anticipated business interruption losses for a period of \_\_\_\_ months
- Equipment breakdown (formerly boiler and machinery) \$ \_\_\_\_\_
- Flood \$ \_\_\_\_\_
- Earth movement \$ \_\_\_\_\_
- Increased limits of ordinance or law coverage to cover increased cost of construction \$ \_\_\_\_\_
- Increased limits of debris removal \$ \_\_\_\_\_
- Plate Glass Sufficient limits to cover plate glass
- Increased limits for signs Sufficient limits to cover exterior signage

2. Comply with the following additional insurance requirements:

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- a. The commercial general liability (or business owner’s property policy) must be
- (i) written on an occurrence basis,
  - (ii) endorsed to name of Landlord, Landlord’s property manager, if any, and Landlord’s Lienholder, if any, as “**additional insureds**,” <sup>88</sup>
  - (iii) include **contractual liability** under Coverage A sufficient to respond to a **broad-form indemnity**, <sup>89</sup>
  - (iv) if Tenant operates multiple locations, be endorsed with a Designated Location(s) General Aggregate Limit endorsement, and
  - (v) be primary and noncontributory with Landlord’s liability insurance coverage.
- b. The commercial property insurance policies must contain
- (i) a **waiver of subrogation clause** in favor of the party not carrying the commercial property insurance [./and]
  - (ii) waivers of subrogation of claims **against Landlord and Lienholder** [**include if applicable:** [./ and]
  - (iii) coverage for agreed value to eliminate the coinsurance clause] [**include if applicable:** and
  - (iv) coverage for replacement cost].
- c. Certificates of insurance and copies of any additional insured and waiver of subrogation endorsements must be delivered by Tenant to Landlord before entering the Premises and thereafter at least ten days before the expiration of the policies.

3. Obtain the approval of Landlord<sup>90</sup> and Lienholder with respect to the following: the forms of Tenant’s insurance policies, endorsements and certificates, and other evidence of Tenant’s Insurance; the amounts of any deductibles or self-insured retentions amounts under Tenant’s Insurance; and the creditworthiness and ratings of the insurance companies issuing Tenant’s Insurance.

**B. Landlord agrees to** maintain the property and/or liability insurance policies **required** below (mark applicable boxes) during the Term:<sup>91</sup>

**Type of Insurance**

**Minimum Policy Limit**

- |  |   |
|--|---|
| <input type="checkbox"/> Commercial general liability <sup>92</sup><br>(occurrence basis)  | Each occurrence: \$ _____<br>General aggregate: \$ _____  |
| <input type="checkbox"/> Commercial property insurance<br>written on a causes of loss—special form<br>(formerly known as “all risks” form) | 100 percent of replacement cost of the [Shopping Center/Building] exclusive of foundation, footings, infrastructure, sitework, and the rebuilding requirements of all lessees, and will include waiver of subrogation referenced in paragraph A.2b. |

## 2. ISO CP 00 90 07 88 Commercial Property Conditions

The following provision, which is contained in the ISO Form of Commercial Property Conditions, is the provision that grants the insurer a contractual right to recover amounts paid by the insurer to others under the policy from third persons that may be liable to the insured for such amounts (*i.e.*, a contractual right of subrogation) (highlighting and emphasis added by authors):

### I. TRANSFER OF RIGHTS OF RECOVERY AGAINST OTHERS TO US

If any person or organization to or for whom we make payment under this coverage part has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing after loss to impair them. But you may waive your rights against another party in writing:

1. **Prior** to a loss to your covered property or covered income.
2. **After** a loss to your covered property or covered income only if, at time of loss, that party is one of the following:
  - a. Someone insured by this insurance;
  - b. A business firm:
    - (1) Owned or controlled by you; or
    - (2) That owns or controls you; or
  - c. Your tenant. <sup>93</sup>

This will not restrict your insurance.

## ENDNOTES

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<sup>1</sup> **Subrogation.** "Subrogation" is defined in BLACK'S LAW DICTIONARY 10<sup>th</sup> Ed. (2014), Thompson Reuters, p. 1654 in the context of insurance as follows:

3. The principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy.

"Subrogation clause" is defined in BLACK'S LAW DICTIONARY 10<sup>th</sup> Ed. (2014), Thompson Reuters, p. 1655 in the context of insurance as follows:

1. Insurance. A provision in a property- or liability-insurance policy whereby the insurer acquires certain rights upon paying a claim for a loss under the policy. • These rights include (1) taking legal action on behalf of the insured to recover the amount of the loss from the party who caused the loss....

<sup>2</sup> **Premises Liability.** In *Occidental Chem. Corp. v. Jenkins*, 478 S.W.3d 649, 644 (Tex. 2016) the Texas Supreme Court reviews the relationship between premises liability and general tort liability, stating

Depending on the circumstances, a person injured on another's property may have either a negligence claim or a premises liability claim against the owner....When the injury is the result of a contemporaneous, negligent activity on the property, ordinary negligence principles apply. *Id.* When the injury is the result of the property's condition rather than an activity, premises-liability principles apply. *Id.* Although premises liability is itself of negligence law, it is a "special form" with different elements that define a property owner or occupant's duty with respect to those that who enter the property. *Id.*

A premises liability claim encompasses a nonfeasance theory of negligence based on the failure of the owner or occupier or controller to take reasonable measures to make the premises reasonably safe. *See Del Lago Partners, Inc. v. Smith*, 307 S.W.3d 762, 776 (Tex. 2010).

<sup>3</sup> **Control vs. Possession.** The party that "controls" a premises is the party with the duty under premises liability law. "Control means the power or authority to manage, direct, govern, administer, or oversee." *American Fid. & Cas. Co. v. Traders & Gen. Ins. Co.*, 334 S.W.2d 772, 775 (Tex. 1960). "Possession," of property involves an element of control except in circumstances of strict liability. As to "possession" involving an element of control, see RESTATEMENT (SECOND) OF TORTS § 328E (1965):

A possessor of land is

- (a) a person who is in occupation of the land with intent to control it, or
- (b) a person who has been in occupation of land with intent to control it, if no other person has subsequently occupied it with intent to control it, or
- (c) a person who is entitled to immediate occupation of the land, if no other person is in possession under Clauses (a) and (b).

**Illinois.** In Illinois, and perhaps other jurisdictions, the common law duty has been codified and there is no distinction between the duties owed by an owner or occupier of premises to invitees and licensees. In both cases, the duty is "that of reasonable care under the circumstances regarding the state of the premises or acts done or omitted on them." 740 ILCS 130/2. An attempt was made at one point in Illinois to codify certain exclusions to this statutory provision and also to add exclusions for duties to trespassers. However, in *Best v. Taylor Machine Works*, 179 Ill. 2d 367, 228 Ill. Dec. 636, 689 N.E.2d 1954 (1997), the Illinois Supreme Court held the entire Public Act in which these and other tort reform measures were enacted unconstitutional (although it did not specifically address the Premises Liability Act amendments).

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<sup>4</sup> **First Party Coverage.** Property insurance is considered “**first party coverage**” because it reimburses the insured (typically the property owner) for its own loss – the value of its insured property if it is damaged or destroyed by a covered peril (called a “**covered cause of loss**” in a standard **ISO CP 00 10 10 12** Building and Personal Property Coverage Form policy). If the property owner elects to include loss of business income and rental value as following additional coverages, it can also be compensated for certain business income and rental value losses if those losses occur as a result of a covered cause of loss. According to the International Risk Management Institute, Inc. (“**IRMI**”), Commercial Property Coverage Forms issued by ISO are

the forms that define, limit, and explain what property or property interest is covered. An ISO commercial property policy consists of: one or more coverage forms, one or more causes of loss forms, the commercial property conditions form, the common policy conditions form, and the declarations. The most widely used ISO commercial property coverage forms are the building and personal property coverage form (CP 00 10) and the business income and extra expense coverage form (CP 00 30).

See <https://www.irmi.com/term/insurance-definitions/commercial-property-coverage-forms> (last visited May 28, 2020).

<sup>5</sup> **Third Party Coverage.** Commercial general liability (CGL) insurance is considered “third party coverage” because it pays amounts the insured becomes legally obligated to pay to a third party as a result of “bodily injury” or “property damage” caused by an “occurrence” covered by the policy (in a standard **ISO CG 00 01 04 13** Commercial General Liability Coverage Form policy ). The insurer also has a duty to defend the insured against such claims, which means the insurer will pay the costs of the insured’s defense (subject to the conditions in the policy).

<sup>6</sup> **CGL Damaged Property Insurance Exclusion.** ISO CG 00 01 04 13 Commercial General Liability Coverage Form, Coverage A, Par. 2 Exclusions - j.(1) Damage to Property.

<sup>7</sup> **Casualty Losses.** The term “**casualty**” is a short-hand term often used in leases to describe perils covered by a first party property insurance policy. In the insurance industry, a “**casualty**” is an occurrence covered by a third party commercial general liability (or CGL) insurance policy (often referred to as casualty insurance). (See definition of “Casualty Insurance” on the IRMI website at <https://www.irmi.com/term/insurance-definitions/casualty-insurance> (last visited May 28, 2020):

Casualty Insurance — insurance that is primarily concerned with the losses caused by injuries to persons and legal liability imposed on the insured for such injury or for damage to property of others.

**Practice Point:** Thus, it is important that the use of the term “**casualty**” in a lease must be as a defined term if it is intended to refer to perils covered by a property insurance policy.

<sup>8</sup> **Contractual Indemnity Provision.** The Retail Lease **Form 1** attached in the Appendix to this article contains reciprocal contractual indemnities, by Tenant at ¶ *B.1.q* and by Landlord at ¶ *C.1.f*.

<sup>9</sup> **Insurance.** The Retail Lease **Form 1** attached in the Appendix to this article contains contractual insurance provisions in the Insurance Addendum to Lease which accompanies the Lease form.

<sup>10</sup> **Subrogation and Waiver of Subrogation.** The Retail Lease **Form 1** attached in the Appendix of Forms contains a contractual release of claims and a contractual waiver of subrogation provision at ¶ *D.4*.

<sup>11</sup> **Indemnity.** An “**Indemnity**” is, “*I agree to be liable for your wrongs.*” Indemnity is a shifting of the risk of a loss from a liable person to another. The risk of loss may be contractual or tortious. Many times, scrivener use an indemnity provision when they do not know whether the Protected Party is a potentially liable person. Sometimes, an indemnity provision is no more than a restatement of existing duties, “*I will indemnify you for my wrongs;*” “*You will indemnify me for your wrongs.*” Indemnity agreements are strictly construed in favor of the Protecting Party.

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However, it is not necessary that the words “indemnify”, or “indemnity” be used or even that the promise be in writing. 14 TEX. JUR. 3d *Contribution and Indemnification* § 14 Form; 26 TEX. JUR. 3d *Statute of Frauds* § 29.

<sup>12</sup> **Exclusion for “Expected or Intended Injury.”** Section I.2.a of the ISO CG 00 01 04 13 Commercial General Liability Coverage Form policy provides that the insurance does not apply to “‘bodily injury’ or ‘property damage’ expected or intended from the standpoint of the insured.”

<sup>13</sup> **CGL Policy Exclusion for Damage to Property “Owned, Rented or Occupied” by the Insured.** As noted at the beginning of this Article, Section I.2.j of the ISO CG 00 01 04 13 Commercial General Liability Coverage Form policy excludes from coverage any damage to “Property you own, rent, or occupy, including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another’s property.” The goal behind such a provision is, of course, to force the tenant (if it is obligated under its lease to insure damage to the leased premises) or the landlord or the tenant (depending on which one is obligated under the lease to insure damage to the leased premises) to procure first party property damage insurance.

**Contractual Liability Insurance.** There is some relief provided to tenants and landlords under an exception to the exclusion for “contractual liability” under Section I.2.b of the ISO CG 00 01 04 13 Commercial General Liability Coverage Form policy. For example, “contractual liability” is excluded from coverage *unless* the insured would have been liable in the absence of the contract or agreement (so far so good, since the exception to the exclusion would cover negligent damage for which the tenant would be liable in tort) or the contract or agreement is an “insured contract” (so far so good, as a “contract for a lease of premises” is an “insured contract” under the definition in Section V.9.a). However, the Section V.9.a definition of “insured contract” goes on to provide that any portion of a lease that indemnifies anyone “for damage by fire to premises while rented to you” is not an “insured contract.”

Reading all of these provisions together leaves the insured tenant with coverage only for non-fire property damage to its landlord’s premises or property (*e.g.*, damage to the premises caused when an employee negligently punctures a water pipe behind the wall in the premises by pounding a hole in it or hitting it with a piece of equipment, but not for fire damage due to a tenant proverbially “*leaving the coffee pot on overnight in the office building*”), but the coverage may be subject to any sublimit for property damage specified in the tenant’s CGL policy declarations.

<sup>14</sup> **Statutory Prohibition on Landlord Indemnification. Illinois and Some Other States.** For example, under Section 1(a) of the Illinois Landlord and Tenant Act, 765 ILCS 705/1(a),

every covenant, agreement, or understanding in or in connection with or collateral to any lease of real property, exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his or her agents, servants or employees, in the operation or maintenance of the demised premises or the real property containing the demised premises shall be deemed to be void as against public policy and wholly unenforceable.

There is an exception to this general rule, however, in Section 1(b) of Illinois Landlord and Tenant Act, 765 ILCS 705/1(b), which states that Section 1(a) “*does not apply to a provision in a non-residential lease that exempts the lessor from liability for property damage.*” Thus, landlord indemnification provisions in commercial leases in Illinois must be carefully drafted to avoid running afoul of the statutory prohibition and yet take advantage of the ability to exempt the landlord from liability for damage to the tenant’s own personal property or betterments and improvements. This issue is discussed in Part III.C.6 of this Article in the context of overly broad lease indemnification provisions.

**Texas and Some Other States.** Although Texas does not have a statute like Illinois expressly directed at landlord-tenant agreements, Texas has adopted an anti-indemnity/anti-additional insured statute declaring void indemnities and additional insured coverage in “construction contracts”. See Endnote 68 (Texas Anti-Indemnity Act) .

<sup>15</sup> **“Casualty Losses”.** See discussion at Endnote 6 (CGL Damaged Property Insurance Exclusion).

<sup>16</sup> **ISO Additional Insured Protection of the Landlord.**

**ISO CG 20 11 12 19 Additional Insured - Managers of Lessors of Premises.** Under the most recent revision of the additional insured endorsement produced by ISO in December 2019, ISO added to the **ISO CG 20 11 12 19 Additional Insured - Managers of Lessors of Premises**, insuring the landlord as an additional insured on its tenant’s CGL policy, a new limitation to coverage of the landlord. ISO added as a condition to coverage that the liability has to have been *caused in whole or in part, by the tenant* (the “**December 2019 Limitation**”). The operative language of the **ISO CG 20 11 12 19** is as follows:

Who is An Insured is amended to include as an additional insured the person(s) or organizations(s) show in the Schedule, but only with respect to liability for “bodily injury”, “property damage” or “personal and advertising injury” *caused in whole or in part, by you* (“you” refers to the tenant) or those acting on your behalf in connection with the ownership, maintenance or use of that part of the premises leased to you” and shown in the Schedule....

In the earlier April 2013 ISO revision, ISO added three new limitations (the “**April 2013 Limitations**”), limiting coverage so that **(1)** coverage “*only applies to the extent permitted by law*”, **(2)** coverage “*will not be broader than that which you are required by the contract or agreement to provide such additional insured,*” and **(3)** the limits are limited to the limits “*required by the contract.*”

**ISO CG 20 24 12 19 Additional Insured – Owners or Other Interests From Whom Land Has Been Leased.**

An identical progression of limitations additions occurred in December 2019 and in April 2013 as to the additional insured protection of a landlords of ground leases. The additional insured coverage language of the **ISO CG 20 24 12 19 Additional Insured – Owners or Other Interests From Whom Land Has Been Leased**, is identical to the **ISO CG 20 11 12 19**, except the reference to “*that part of the premises leased to you*” reads “that part of the land leased to you and shown in the Schedule,....” and is followed by the April 2013 Limitations.

**ISO April 2013 ISO CG 20 11 04 13 Additional Insured Endorsement without the December 2019 Limitation.**

The **ISO CG 20 11 04 13 Additional Insured – Managers or Lessors of Premises**, where the landlord and its property manager will be covered for “premises liability” type claims – claims without regard to who caused the liability is still available. The operative language of the **ISO CG 20 11 04 13** is as follows:

Who is An Insured is amended to include as an additional insured the person(s) or organizations(s) show in the Schedule, but only with respect to liability for ~~“bodily injury”, “property damage” or “personal and advertising injury”~~ *caused in whole or in part, by you* (“you” refers to the tenant) ~~or those acting on your behalf in connection with~~ arising out of the ownership, maintenance or use of that part of the premises leased to you” and shown in the Schedule,....

(for illustration purposes the language not contained in in the April 2013 endorsement but added in the later December 2019 endorsement is shown in ~~strikeout~~.)

Thus, the coverage available to the landlord from a tenant’s CGL policy will depend on the type of additional insured endorsement procured by the tenant. The difference between an obligation to procure and maintain insurance and to indemnify is discussed in Part V.C (Best Practice Tips - Importance of Review Insurance Policies Against Indemnification Obligations), but those cases all predate these newer forms of Additional Insured endorsements.

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<sup>17</sup> **Transfer of Rights of Recovery (i.e., Contractual Subrogation).** For example, Section IV.8 of the ISO Form **CG 00 01 04 13** Commercial General Liability Coverage Form policy, contains a provision called “Transfer Of Rights Of Recovery Against Others To Us,” which provides (Italics added):

If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The insured must do nothing *after loss* to impair them. At our request, the insured will bring “suit” or transfer those rights to us and help us enforce them.

Similarly, Section I of the **ISO CP 00 90 07 88** Commercial Property Conditions Form contains a provision called “Transfer to Rights of Recovery Against Others To Us.” The relevant text included in this form is set forth in **Form 2** of the Appendix to this article.

<sup>18</sup> **History of and Reasons for Subrogation.** For a discussion of the history behind the various types of subrogation and the benefits of subrogation as well as the arguments against it in the context of an insurer’s rights of subrogation, see Gary L. Wickert, *The Societal Benefits of Subrogation*, which is available on line at <https://www.mwl-law.com/wp-content/uploads/2013/03/the-societal-benefits-of-subrogation.pdf> (last visited March 18, 2019).

<sup>19</sup> **Release.** A “Release” is, “*You are not liable to me for your wrongs.*” A release is an agreement in which one party agrees to hold the other without responsibility for damage or other liability arising out of the transaction involved.

<sup>20</sup> **Exculpation.** “Exculpation” is, “*I am not liable to you for my wrongs.*” An exculpatory provision is designed to exclude, as between the parties to a contract, certain designated duties, liabilities or costs due to the occurrence or nonoccurrence of events.

<sup>21</sup> **Contractual Waivers of Claims and Waivers of Subrogation.** The Retail Lease attached as **Form 1** in the Appendix of forms contains a contractual waiver of claims and waiver of subrogation at ¶ **D.4**. The waiver is limited to property loss. This type of provision is used to give effect to the parties’ intent that the property insurance policies required by the lease provide the source of recovery for the loss. “**Subrogation**” refers to the right of an insurer to be put in the shoes of its insured with respect to recovery rights against a third party (in the context of a lease, the party not “providing” the insurance) that is legally responsible for the loss, to the extent of the amount paid by the insurer. By a contractual release of claims and waiver of subrogation, a party gives up the right of recovery against the other party. In waiving its own recovery rights, the releasing party precludes its insurer from exercising those rights on its behalf. The following example is set out in IRMI CONTRACTUAL RISK TRANSFER at Commercial Real Estate Leases: Waivers of Subrogation:

Assume a fire that starts in the tenant's space spreads to other areas and partially destroys a multitenant building. The tenant's (first-party) property insurance policy covers the tenant's loss of personal property; the damage to the building is covered under the landlord's property insurance policy. The tenant's and the landlord's property insurers are subrogated to their insureds' respective rights against the other party. Without waivers of subrogation, two lawsuits inevitably will follow.

- Lawsuit No. 1 by the landlord's property insurer against the tenant, to recover the cost to repair the fire damage to the building. The tenant, in turn, will tender defense of this lawsuit to its CGL insurer.
- Lawsuit No. 2 by the tenant's property insurer against the landlord, to recover the cost to replace the tenant's personal property. The landlord, in turn, will tender defense of this lawsuit to its CGL insurer.

This outcome is costly and inefficient because it requires litigation among four insurers to determine which party(ies) caused the loss and which insurer(s) ultimately will pay for the

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damages. It is undesirable from a business perspective because it places the landlord and the tenant in an adversarial relationship.

Also, the absence of waivers of subrogation can present economic risk to the parties. In the example just cited, there is risk for the landlord if the tenant's CGL insurance does not cover the loss or is inadequate to cover the loss, or if the tenant is subject to large deductibles or self-insured retentions. In short, the threat of a subrogation judgment against the tenant could be significant enough to threaten the tenant's solvency. This is contrary to the landlord's fundamental business interest in maintaining a paying tenant.

<sup>22</sup> **ISO Form CP 00 90 07 88 Commercial Property Conditions Form.** For the text of this provision, *see* Section I of the ISO Form CP 00 90 07 88 Commercial Property Conditions Form reprinted as **Form 2** in the Appendix of Forms.

<sup>23</sup> **ISO Additional Insured Forms For Contractor Insurance Policies.** For example, under certain ISO Forms of Additional Insured endorsements (*see e.g.*, **CG 20 33 04 13** Additional Insured – Owners, Lessees or Contractors – Automatic Status When Required in Construction Agreement with You and **CG 20 37 12 19** Additional Insured – Owners, Lessees or Contractors – Completed Operations), the additional insured insurance *only includes persons for whom the contractor is performing operations* (aka privity) when the contractor and the named insured have entered into an agreement calling for the additional insured to be added as an additional insured or where the contractor's work is performed for the additional insured. If the tenant hires a contractor, even if the construction contract calls for the landlord to be named as an additional insured, the landlord will not be covered under this form of Additional Insured endorsements *because the operations or work will not be performed for the landlord or under an agreement with the landlord*. However, if the tenant's contractor obtains an **ISO CG 20 38 04 13** Additional Insured – Owners, Lessees or Contractors – Automatic Status for Other Parties When Required in Written Construction Agreement form of additional insured endorsement, the *landlord would be an additional insured if* the construction contract between the tenant and the contractor specifically provides that the landlord will be added as an additional insured on the contractor's CGL policy.

<sup>24</sup> **ISO Form of "Waiver of Subrogation" Endorsement.** ISO does issue a CGL policy endorsement ISO Form **CG 24 04 12 19** – Waiver of Rights of Recovery Against Others to Us (Waiver of Subrogation). This form specifically names the person or organization with respect to which the insurer waives its right of recovery.

<sup>25</sup> **Waiver of Subrogation Factored in Advance into Insurer's Risk and Premium.** E. Patterson, ESSENTIALS OF INSURANCE LAW 122 (1935) made the following text book argument for this business practice:

[Subrogation] plays no part in the rate schedules (or only a minor one), and no reduction is made in insuring interest, such as that of the secured creditor, whether the subrogation right will obviously be worth something. Hence, in such case, no reason appears for extending it. Even as to tortfeasors, it is arguable that since insurers take the risk of negligence losses, they should not shift the loss to another.

<sup>26</sup> **Fifty-State Survey on Landlord/Tenant Subrogation Rights.** For a comprehensive survey of the law in all fifty states as to whether they allow subrogation, deny subrogation or determine the right of an insurance company to exercise a right of subrogation on a case-by-case basis in the context of the landlord/tenant relationship, *see* Matthiesen, Wickert & Lehrer, S.C., "Landlord/Tenant Subrogation in All 50 States" available at <https://www.mwl-law.com> (last visited May 28, 2020; last updated March 26, 2020). Many of the following case summaries appear in their article.

#### **Alabama.**

*McCay v. Big Town, Inc.*, 293 Ala. 582, 307 So.2d 695 (Ala. 1975). If a lease clearly and unambiguously states that each party agrees to cause the property insurance policy on the property to contain a waiver of subrogation or endorsement under which the insurance company waives its right of subrogation against parties to the lease, each

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party waives any cause of action against the other in case its property is damaged as the result of the other party's negligence.

**Alaska.**

*Alaska Ins. Co. v. RCA Alaska Communications, Inc.* 623 P.2d 1216 (Alaska 1981). A property insurer is not entitled, as subrogee, to bring an action against a tenant to recover for amounts paid to its landlord for fire damage to the leased premises caused by the tenant's negligence in the absence of an express agreement between landlord and tenant to the contrary. Landlord and tenant are considered co-insureds under the property insurance policy.

A later case, *Great American Ins. Co. v. Bar Club, Inc.*, 921 P.2d 626 (Alaska 1996), indicates that the tenant is a co-insured under a lease only if the lease expressly provides that the tenant is a co-insured. In *Bar Club, Inc.* the tenant's insurer sued the landlord for negligently causing a fire; the court held that since the policy was purchased by the tenant and named only the tenant as the insured, equitable principles underlying the "implied insured doctrine" did not apply.

**Arizona: Case-by-Case.**

Arizona has avoided a *per se* rule and taken a flexible case-by-case approach, holding in *General Accident Fire & Life Assurance Corp. v. Traders Furniture Co.*, 401 P.2d 1957 (Ariz. App. 1981) that a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties as ascertained by the court from a review of the lease as a whole.

**Arkansas: Case-by-Case.**

*Page v. Scott*, 567 S.W.2d 101, 103 (Ark. 1978) the court held that a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties as ascertained from the lease as a whole.

**California: Case-by-Case.**

In the recent case, *Western Heritage Ins. Co. v. Frances Todd, Inc.*, 33 Cal. App.5th 976 (Ct. App., 1st Dist., Div. 5 2019), the court was faced with determining whether a condominium association insurer could subrogate against a negligent tenant (Frances Todd, Inc.) of a condo owner (William R. de Carion) for a fire loss. The property insurer (Western Heritage) issued property insurance to the condominium association pursuant to the following provisions in the condominium CC & Rs referenced by the court (reformatted by author):

Article 13.1 of the Declaration of Codes, Covenants and Restrictions (CC & Rs) applicable to the property requires the Association to "obtain and maintain a master or blanket policy of all risk property insurance coverage for all Improvements within the Project, insuring against loss or damage by fire or other casualty. ... The policy shall name as insured the Association, the Owners and all Mortgagees of record, as their respective interests may appear."

Article 13.3 provides in part, "Any insurance maintained by the Association shall contain [a] 'waiver of subrogation' as to the Association, its officers, Owners and the occupants of the Units and Mortgagees. ..."

Article 13.4 prohibits an individual owner from obtaining fire insurance while allowing an owner to obtain individual liability insurance.

Article 3.1 requires that all "occupants and tenants" comply with the CC & Rs.

The court noted that the lease between the condominium owner and the tenant contained the following provisions (reformatted by author):

Paragraph 5 of the Lease provided, "Lessee shall not commit waste, nor carry on any activity which would destroy or impair the quiet enjoyment of other lessees in the building of which the Premises form a part."

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Paragraph 6 required the Lessee to keep the Premises in good repair.

Paragraph 8(A) required the Lessee to “keep in force a public *liability* insurance policy covering the leased premises, including parking areas, if any, included in this Lease, insuring Lessee and naming Lessor as an additional insured. ... Said insurance policy shall have minimum limits of coverage of \$ 1,000,000 in the aggregate.” (Italics added.) The Lease did not specify which party (Lessor or Lessee) would carry *fire* insurance.

Paragraph 9(B) of the Lease, entitled “Lessor’s Right to Recover Damage(s),” provided,

“Such efforts as Lessor may make to mitigate damages caused by Lessee’s breach of this Lease shall not constitute a waiver of Lessor’s right to recover damages against Lessee hereunder. Nor shall anything herein contained affect Lessor’s right to indemnification against Lessee for any liability arising prior to the termination of this Lease for personal injuries or property damage resulting from the acts or omissions of Lessee, and Lessee hereby agrees to indemnify and hold Lessor harmless from any such injuries or property damages ... except for damages occasioned by Lessor’s intentional or grossly negligent acts.”

Paragraph 11 of the Lease provided in relevant part,

“Lessee agrees to surrender the Premises at the termination of the tenancy herein created, in substantially the same condition as they were on the Commencement Date, reasonable wear and tear, casualty, and any alterations, improvements, and/or additions which are the property of Lessor under Paragraph 7 excepted.”

Paragraph 19 allowed either party to terminate the lease when damage due to fire, other casualty or eminent domain rendered ten percent or more of the property “untenantable.” In the event the fire, other casualty or taking rendered less than ten percent of the property untenable, “the Lessor shall proceed to repair the Premises and/or the building and/or the property of which the Premises are a part to the extent of any insurance proceeds received on account of a Casualty....”

The court held (reformatted by author):

In this case, we conclude the Western Heritage policy was maintained for defendants’ benefit and that summary judgment was properly granted in their favor.

First, the Lease in this case required defendants to obtain only liability insurance, not fire insurance. The implication was that fire insurance would be carried by the lessor, de Carion. William R. de Carion was an additional named insured on the insurance policy purchased by the Association, as the CC & Rs governing the property required.

Second, owners such as de Carion were prohibited by the CC & Rs from purchasing an individual fire policy, as were “occupants” and “tenants” of the premises to whom the CC & Rs applied. (See Policy, [¶] [¶] 3.1, 13.4.) Defendants could not, therefore, purchase their own first-party fire insurance for the structure (a structure in which they held no ownership interest).

Third, the **yield-up clause** in this case provided that defendants, as lessees, agreed to “surrender the Premises at the termination of the tenancy herein created, in substantially the same condition as they were on the Commencement Date, reasonable wear and tear, *casualty*, and any alterations, improvements, and/or additions which are the property of the Lessor under Paragraph 7 excepted.” (Lease, [¶] 11, italics added.) “Casualty” includes damage from fire.

... But whether or not de Carion was named as an insured under the first party fire provisions, the CC & Rs, which formed a contract between de Carion and the Association (citations omitted), contemplated that he would be. They also provided that in any such policy, the Association secure a waiver of any right the insurance company might have to a subrogation action against the owners or tenants of the project. It would

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be inequitable under these circumstances to treat the Association as the sole insured for purposes of Western Heritage's right to bring a subrogation action to recover amounts paid under its fire policy.

In *State Farm Gen Ins. Co. vs Wells Fargo Bank, N.A.*, 49 Cal. Rptr.3d 785 (Cal. App. 2006), the court applied the doctrine of superior equities applied and prevented an insurer from subrogating against a party whose equities are equal or superior to those of the insurer.

In *Fire Ins. Exch. v. Hammond*, 83 Cal. App. 4<sup>th</sup> 313, 99 Cal. Rptr. 2d 596, 602 (Cal. 2000), the court held that a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties as ascertained from the lease as a whole. In *Hammond* California has generally held that a tenant is not responsible for damages where the landlord and tenant intend the landlord's property policy to be for their mutual benefit.

The court in *Parsons Mfg. Corp. v. Superior Court*, 203 Cal. App. 1984) held that where the lease

advertises to the possibility of fire and there is no clear language or other admissible evidence showing an agreement to the contrary, a lease agreement should be read to place on the lessor the burden of insuring the premises (as distinguished from the lessee's personal property) against lessor and lessee negligence.

The court held that the tenant was an *implied co-insured* of the landlord and subrogation against the tenant was barred because there was no express agreement that tenant would obtain its own fire insurance.

In *Liberty Mutual Fire Ins. Co. v. Auto Spring Supply Co.*, 59 Cal. App.3d 860 (Cal. App. 1976), the tenant's insurer was denied subrogation against the sub-tenant where the sub-tenant's rent covered the premium on the tenant's fire policy and proceeds of the policy were to be used to repair fire damages. The court held it was obvious from these provisions that the parties to the lease and the sublease all intended that the proceeds of the insurance company's property policy, maintained by the tenant at the sub-tenant's expense, were to constitute the protection of all parties to the lease against fire loss.

This was the commercial expectation of these parties. Stated otherwise, under the facts of this case, we regard the subtenant ... as an implied in law co-insured of [the tenant], absent an express agreement between them to the contrary. *Id.* at p. 865.

In *Fred A. Chapin Lumber Co. v. Lumber Bargains, Inc.*, 189 Cal. App. 2d 613 (Cal. App. 1961), a landlord's policy was held to be for the mutual benefit of the landlord and tenant where the lease expressly required the landlord to maintain fire insurance. This rule was followed in *Gordon v. J.C. Penney Co.*, 7 Cal. App.3d 280 (Cal. App. 1970), in which the court affirmed a judgment in favor of the tenant and stated

A fire insurance policy which does not cover fires caused or contributed to by the insured would be an oddity indeed.... Otherwise, few insured fire claims would be paid without controversy and most would require litigation.

For that reason, courts in California do not deem that a policy "for the benefit" of a tenant excludes coverage for fires caused by his negligence.

### **Colorado: Subrogation Permitted.**

*U.S. Fidelity & Guar. Co. v. Let's Frame It, Inc.*, 759 P.2d 819 (Colo. App. 1988) The court determined that the redelivery clause in lease has applicability only to the leased premises and cannot affect tenant's liability for damage done to landlord's other property.

A landlord's insurer may recover against a tenant only if the landlord has the right to recover against the tenant; *Employers Cas. Co. v. D.M. Wainwright*, 473 P.2d 181 (Colo. 1970). The ultimate question presented is whether provisions of the written lease between the tenant and its landlord have circumscribed the landlord's right of recovery under the circumstances of the case.

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**Connecticut: Hybrid Implied Co-Insureds and Case-by-Case.**

*Amica Mut. Ins. Co. v. Muldowney*, 180 A.3d 950 (Conn. 2018). In this case, the Connecticut Supreme Court loosened its prior rule and held that the lease does not have to expressly state that a landlord's insurer has a right of subrogation against a tenant in order for subrogation to be allowed. The court held it was sufficient for the lease to notify the tenant explicitly that it is responsible for damage to the leased premises and to allocate to the tenant the responsibility to provide liability and property damage insurance. The lease provided for the tenant to take certain actions designed to guard against frozen pipes and subsequent water damage. The lease stated that if tenant breached the lease, the tenant had to pay for repairs if its actions made the premises unfit or unlivable and to hold the landlord harmless for any loss arising out of the tenant's use or occupancy of the premises. The court held that the landlord and tenant had a "specific agreement" sufficient to overcome the default presumption that the landlord's insurer had no right of subrogation.

*Amica Mut. Ins. Co. v. Andresky*, 2012 WL 527678 (Conn. Super. Ct. 2012), the court found the following lease language was "far more clear" and held the tenant was liable to the landlord's insurer:

(1) that tenant (defendants) would obtain public liability and fire insurance for the benefit of the landlord and the tenant in the amount of \$500,000 for liability and \$500,000 for fire, and (2) the tenant would pay all costs if repair is required because of misuse or neglect by tenant, his family or anyone else on the premises.

*Middlesex Mutual Assurance Co. v. Vaszil*, 279 Conn. 28 (Conn. 2006). The court held that the lease in question did "not remotely inform the defendant that they would be liable to their landlord's insurer" for fire damages to the landlord's building, nor did it inform the defendant of the need to obtain fire insurance "to cover the value of the entire multi-unit apartment building. The court found that the lease was ambiguous about whether the defendant's liability was limited to loss of the security deposit, so no subrogation was allowed.

*Wasko v. Manella*, 849 A.2d 777 (Conn. 2004), the policy must contain specific right of subrogation language. C.G.S.A. § 38a-308 provides that an insurer "may require" from the insured an assignment of all right of recovery against any party for loss to the extent payment is made by the insurer. This statutory language does not create a right of subrogation in the insurer.

*DiLullo v. Joseph*, 792 A.2d 819 (Conn. 2002) - the Connecticut Supreme Court established a "default rule of law" where there is no agreement between the landlord and tenant as to who bears the risk of loss. The "default rule" is that, unless the lease refers to a right of subrogation, no right of subrogation exists. The court noted that

tenants and landlords are always free to allocate their risks and coverages by specific agreements, in their leases or otherwise. *Id.*

The *DiLullo* court agreed with criticisms of the *Sutton* rationale but ultimately concluded that "the *Sutton* result" was "sound as a matter of subrogation law and policy," based on the "strong public policy" disfavoring economic waste. The *DiLullo* court stated that to hold otherwise

would create a strong incentive for every tenant to carry liability insurance in an amount necessary to compensate for the value, or perhaps even the replacement cost, of the entire building, irrespective of the portion of the building occupied by the tenant. That is precisely the same value or replacement cost insured by the landlord under his fire insurance policy. Thus, although the two forms of insurance would be different, the economic interest insured would be the same. This duplication of insurance would, in our view, constitute economic waste and, in a multiunit building, the waste would be compounded by the number of tenants.

*St. Paul Fire & Marine Ins. Co. v. Durr*, 2001 WL 984782 (Conn. Super. 2001) - tenants are implied co-insureds under a landlord's fire policy and may not be sued for their negligence as they are insured under the policy.

**Delaware: Implied Co-Insureds.**

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*Lexington Ins. Co. v. Roboin*, 712 A.2d 1011, 1016 (Del. Super. Ct. 1988), *aff'd* 723 A.2d 397 (Del. 1998), implied co-insureds in the absence of an express agreement between landlord and tenant to the contrary in the residential lease.

Followed in *Deloach v. Houser*, 2018 WL 5899080 (Del. Super. 2018).

**Florida: Case-by-Case.**

See discussion of *Zurich Am. Ins. Co. v. Puccini, LLC*, 271 So.3d 1079 (Fla. App. - Third District 2019), review denied, 2019 WL 4266002 (Fla. 2019) in Endnote 29. Court held that the risk-allocating provision in *Puccini* did not show an intent to shift the risk of loss from a negligent tenant to the landlord's insurer. Instead, the clear intent was that the tenant would bear the risk of loss due to damage resulting from tenant's negligence. The court found that the tenant was not an implied co-insured unclear Zurich's policy and, therefore, Zurich could proceed with its subrogation action against the Tenant.

*State Farm Florida Ins. Co. v. Loo*, 2010 WL 445945 (Fla. App. 2010).

*Continental Ins. Co. v. Kennerson*, 661 So.2d 325, 327 (Fla. App. 1995) (lessee is considered an implied co-insured of lessor for purpose of preventing subrogation).

**Georgia: Case-by-Case.**

*Southern Trust Insurance Co. v. Cravey*, 345 Ga. App. 697, 814 S.E.2d 802 (2018). Landlord's insurer of rented home was entitled to bring subrogation claim seeking pro rata contribution for landlord's loss of home in fire against insurer that had issued homeowner's policy to home's renter, who had rent-to-own contract with landlord concerning home; landlord, as named additional insured in renter's insurance policy, was third-party beneficiary to renter's policy, both policies insured the destroyed home, and both policies clauses that addressed other insurance expressed preference for contribution on pro rata basis.

*Tuxedo Plumbing & Heating Co. v. Lie-Nielsen*, 262 S.E.2d 794 (Ga. 1980). The court held that a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties as ascertained from the lease as a whole.

**Hawaii: Undecided.**

**Idaho: Case-by-Case.**

*Bannock Bldg. Co. v. Sahlberg*, 887 P.2d 1052 (Idaho 1994) - IRMI: Case-by-Case, the court held that a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties as ascertained from the lease as a whole.

*Safeco Ins. Cos. v. Weisgerber*, 767 P.2d 271 (Idaho 1989) - IRMI: implied co-insured.

**Illinois: Case-by-Case.**

**Residential Lease:** See discussion of *Dix Mut. Ins. Co. v. LaFramboise*, 149 Ill.2d 314, 597 N.E.2d 622, 625 (Ill. 1992) in this Article at [Part IIB](#). The Illinois Supreme Court said that although a tenant is generally liable for fire damage caused to the leased premises by her negligence, if the parties intended to exculpate the tenant from negligently caused fire damage, their intent, as expressed in the lease, will be enforced. The court construed the lease as a whole and concluded that it did not reflect any intent that the tenant would be responsible for negligently caused fire damage. Absent such manifest intent, the tenant was held to be a co-insured by virtue of having paid rent which contributed to the insurance premiums, and the insurer could not subrogate against its own insured.

*Pekin Ins. Co. v. Murphy*, 2014 WL 6092187 (Ill. App. 2014) (where lease reflects parties' intent to place responsibility for water damage on the tenant, the tenant will not be considered to be an implied co-insured).

*Auto Owners Ins. Co. a/s/o John Ellis v. Thomas Callaghan*, 952 N.E.2d 119 (Ill. App. 2011) (intent to be gleaned from the four corners of the lease).

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**Oral Lease:** *Cincinnati Ins. Co. v. DuPlessis*, 848 N.E.2d 220 (Ill. App. 2006) (same result in an oral lease). Fact that tenant maintained renter's insurance did not prevent tenant from being treated as a coinsured under landlord's insurance policy, so as to preclude insurer from suing tenant for subrogation in an action arising out of a fire allegedly caused by tenant's negligence; purpose of renter's insurance was different from purpose of casualty or liability insurance.

**Commercial Lease:**

*Nationwide Mut. Fire Ins. Co. v. T&N Master Builder & Renovators*, 959 N.E.2d 201, 355 Ill. Dec. 173, 2011 IL App (2d) 101143 (Ill. App. 2011) (same anti-subrogation rule applicable to residential leases applies to commercial lease where clause holding commercial holdover tenant liable for damages sustained to premises while in tenant's possession did not apply to damages caused by fire because lease surrender clause specifically excepted losses by fire).

*McGinnis ex rel. CIE Serv. Corp. v. LaShelle*, 519 N.E.2d (Ill. App. 1988) (absent express agreement that tenants were not co-insureds under policy, tenants are implied co-insureds on landlord's insurance policy).

*Stein v. Yarnell-Todd Chevrolet, Inc.*, 241 N.E.2d 439, 41 Ill.2d 32 (Ill. 1968). A commercial lease obligated the tenant to procure and maintain certain types of insurance (e.g., plate glass damage, damage by boiler or boiler explosion, public liability and "or injury to employees of the lessee"). 241 N.E.2d 442. The lease was silent on whether the landlord was obligated to carry any insurance, but did obligate the tenant to reimburse the landlord for any premium increases for the landlord's insurance policy and to cease any activity that would "invalidate any insurance policy maintained on the building or leased premises" which meant the parties intended the landlord would carry insurance on the real estate. *Id.* In addition, the lease specified the tenant was to "return the premises and all leasehold improvements and fixtures therein in as good condition as when lessee took possession, ordinary wear and tear or damage by fire or other casualty beyond lessee's control excepted." *Id.* at 440. Accordingly, based on "the lease as a whole, we judge that the parties manifested a pervading intention that the lessee was not to be liable for damage through fire resulting through the lessee's negligence." *Id.* at 443.

**Indiana: Case-by-Case.**

*LBM Realty, LLC v. Mannia*, 19 N.E.3d 379 (Ind. App. 2014). Indiana first adopted the case-by-case rule for determining whether a landlord's insurer could bring subrogation action against a negligent tenant for damage to the leased premises in 2014 in *LBM Realty, LLC v. Mannia*, 19 N.E.3d 379 (Ind. App. 2014). In that case, which contains an extensive summary of the so-called "Sutton Rule" (the majority rule) and the minority rule, the court concluded the landlord's insurance company was entitled to bring a subrogation action against a residential apartment tenant who had caused a fire for damages to the unit she leased, but because there was no clear and enforceable provision in the lease that would have put the tenant on notice she would be responsible for damage to areas of the multi-unit apartment building outside of her leased premises, the insurance company would not be able to seek recovery for those amounts.

In a more recent case, still applying the case-by-case approach, the Indiana Court of Appeals distinguished the holding in the *LBM Realty* case. *See Youell v. Cincinnati Insurance Co.*, 117 N.E.3d 639 (Ind. Ct. App. 2018). The *Youell* case involved a subrogation claim by the landlord's insurer against a commercial tenant. When the building was damaged by a fire, the landlord's insurer paid \$227,653 to repair the damage. The tenant filed a motion for judgment on the pleadings in the case, arguing the insurer had no right to a subrogation claim. The court agreed, holding

the Commercial Lease Agreement unambiguously provides that Landlord would insure the building and Tenant would insure its personal property inside the building. . . . Landlord and Tenant's agreement to insure was thus an agreement to provide both parties with the benefits of the insurance and expressly allocated the risk of loss in case of fire to insurance. 117 N.E.3d at 642.

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The court was able to distinguish the *Youell* case because in *LBM Realty* the lease did not require the landlord to maintain property insurance and only recommended that the tenant obtain renter's insurance; as a result, the parties' expectations with respect to liability for damage to the leased premises was unknown. 117 N.E.3d at 643.

*Hoosier Ins. Co. v. Riggs*, 92 N.E.3d 685 (Ind. App. 2018), the court held that if a lease obligates a tenant to procure insurance covering a particular type of loss, such a provision will provide evidence that the parties reasonably anticipated that the tenant would be liable for that particular loss, which would allow an insurer who pays the loss to bring a subrogation action against the tenant.

*Morsches Lumber, Inc. v. Probst*, 388 N.E.2d 284 (Ind. App. 1979), when lease requires that the landlord will insure the building and tenant will insure its personal property, this was an agreement to provide both parties with the benefits of insurance and constitutes an express allocation of risk of loss to insurance in case of fire damage.

Also see *United Farm Bureau Mut. Ins. Co. v. Owen*, 660 N.E.2d 616 (Ind. App. 1996); *Cincinnati Ins. Co. v. Davis*, 860 N.E.2d 915 (Ind. App. 2007); *St. Paul Fire & Marine Ins. Co. v. Pearson Construction Co.*, 547 N.E.2d 853 (Ind. App. 1989), *trans. denied*.

#### **Iowa: Subrogation Allowed; Anti-Sutton Approach.**

*Neubauer v. Hostetter*, 485 N.W.2d 87, 89-90 (Iowa 1992). The following discussion of the *Neubauer* decision is in IRMI CONTRACTUAL RISK TRANSFER at Subrogation in Real Property Leases:

The landlords owned a farmhouse insured by Farmers Mutual Insurance Association (Farmers Mutual). They rented the farmhouse to Joyce and Jennings Hostetter, pursuant to an oral lease, but the parties never discussed either party's obligations to procure or maintain insurance. However, the landlord subsequently told the tenants to purchase renters insurance to insure their personal property. During the term of the lease, Joyce Hostetter caused a fire that destroyed the farmhouse. After paying the landlords for the damages, Farmers Mutual brought a subrogation action in the landlords' names against the Hostetters. The Hostetters argued that Farmers Mutual could not pursue subrogation against them because they were implied co-insureds under the landlord's insurance policy. The Iowa Supreme Court rejected this argument, holding that the Hostetters were not implied co-insureds under the Farmers Mutual policy. The court found that Farmers Mutual had the right to choose whom it insured and did not choose to insure the Hostetters. Moreover, the implied coinsured approach disregarded the fact that the interests of the landlord and tenant were "separate estates capable of being separately valued and separately insured..." Therefore, if the Hostetters "had a property interest in the dwelling, it was not automatically insured under the landlord's policy." Finally, there was no evidence that the landlords ever agreed to provide insurance covering the Hostetters' tenancy estate. Consequently, Farmers Mutual was not precluded from pursuing a subrogation claim against the Hostetters.

#### **Kansas: Case-by-Case.**

*TMD Southglenn II, LLC v. Parker*, 2014 WL 2589768 (Kan. App. 2014) (the court determined that the tenant was not liable to the landlord for fire damage to the space they leased or other parts of the mall). The premiums for that insurance would amount to an expense in leasing from TMD over and above the monthly rent. Therefore, this case came within the *New Hampshire Insurance* decision (cited below) to the extent the court's ruling required some *mutual benefit* to the fire-loss covenants. Landlord also argued that tenant had liability independent of that result as the tenant indemnified landlord for "all claims arising from the tenant's use of the premises" or "from any breach or default" of the obligations imposed by the lease. The landlord contended it should be able to recover under the indemnification clause regardless of the provisions regarding fire insurance and fire loss. The court disagreed and found that the protections flowing under the indemnification clause were against third-party claims based on the wrongful conduct of the tenants.

*New Hampshire Ins. Co. v. Fox Midwest Theaters Inc.*, 457 P.2d 133 (Kan. 1969). The court noted that the insurance provisions in that case were for the benefit of both the landlord and the tenant (*mutual benefit test*), especially given how any insurance payment for fire loss was to be applied. The lease in that case also required the landlord to repair or rebuild the theater within 60 days after any fire damage. Under a lease agreement providing that landlord would

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purchase fire insurance for adequate protection of improvements on leased premises and tenant would maintain premises in good repair “*damage by fire or other casualty being expressly excepted,*” landlord’s obligation to insure premises insured to benefit of both parties. The exemption from “damage by fire or other casualty” included all fires except those which would be classified as arson, and the tenant was not liable for loss by fire resulting from its negligence.

*Salina Coca-Cola Bottling Corp. v. Rogers*, 237 P.2d 218 (Kan. 1951). Independent of the above statute and an express agreement to insure by the tenant, Kansas common law imposes an obligation on a tenant to return the premises to the landlord at the end of a rental term unimpaired by the tenant’s negligence.

See K.S.A § 58-2555 Duties of Tenants. Tenants shall

(f) be responsible for any destruction, defacement, damage, impairment or removal of any part of the premises caused by an act or omission of the tenant or by any person or animal or pet on the premises at any time with the express or implied permission or consent of the tenant.

### **Kentucky: Case-by-Case.**

A tenant’s liability to the landlord’s insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties to the lease as ascertained from the lease as a whole. The absence from the lease agreement of a requirement that the landlord provide fire insurance generally permits a right of subrogation.

*Britton v. Wooten*, 817 S.W.2d 443, 445-47 (Ky. 1991). The court held that subrogation was allowed because there was no clause requiring purchase of fire insurance by landlord.

*Liberty Mut. Fire Ins. Co. v. Jefferson Family Fair, Inc.*, 521 S.W.2d 244 (Ky. 1975) (the absence from the lease agreement of a requirement that the landlord provide fire insurance generally permits a right of subrogation).

### **Louisiana: Case-by-Case.**

*Home Ins. Co. of Ill. v. National Tea Co.*, 588 So.2d 361 (La. 1991) (a lease provision, under which the landlord agreed to carry fire insurance on property and released tenant “*from any and all claims and damages whatsoever from any cause resulting from or arising out of any fire*” constituted release from fire damage acknowledged to have been caused by tenant’s negligence and extinguished any subrogation recovery by landlord’s insurer).

*American Guar. & Liab. Ins. Co. v. Little*, 328 So.2d 706 (La. Ct. App. 1976) (subrogation permitted against negligent tenant).

### **Maine: Implied Co-Insureds.**

*N. River Ins. Co. v. Snyder*, 804 A.2d 399, 403-04 (Me. 2002) (fire insurer is not entitled, as subrogee, to bring action against tenant to recover for amounts paid to landlord for fire damage to rental premises caused by tenant’s negligence in absence of express agreement between landlord and tenant to contrary).

### **Maryland: Case-by-Case.**

*Rausch v. Allstate Ins. Co.*, 882 A.2d 801 (Md. 2005) (evidence outside the four corners of the lease may be relevant in some cases. The court clarified that a tenant’s liability to the landlord’s insurer depends on the reasonable expectations of the parties to the lease, “as determined from the lease itself and any other admissible evidence.”).

### **Massachusetts: Mixed.**

**Residential: Implied Co-Insureds.** *Federal Ins. Co. v. Commerce Ins. Co.*, 597 F.3d 68 (1<sup>st</sup> Cir. 2010). Under Massachusetts’ implied coinsured doctrine, insurer had no subrogation claim against estate of retirement home resident and resident’s individual liability insurer for payments it made to retirement home owner for its loss resulting from fire caused by resident where, by virtue of provisions of residential lease, which did not contain express provision establishing resident’s liability for negligently caused fire and implied that owner would provide fire protection for the building, resident was mutual insured of owner under its policy.

*Cincinnati Ins. Co. v. DuPlessis*, 848 N.E.2d 220 (Ill. 2d Dist. 2006) (fact that tenant maintained renter’s insurance did not prevent tenant from being treated as a coinsured under landlord’s insurance policy, so as to preclude insurer

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from suing tenant for subrogation in an action arising out of a fire allegedly caused by tenant's negligence; the purpose of renter's insurance was different from purpose of casualty or liability insurance).

*Peterson v. Silva*, 704 N.E.2d 1163 (Mass. 1999). The court held that when a residential landlord sues a tenant for damages to the landlord's, the implied co-insured doctrine presumes that the landlord's liability insurance is held "for the mutual benefit of both parties."

**Commercial: Case-by-Case.** *Seaco Ins. Co. v. Barbosa*, 761 N.E.2d 946, 950 (Mass. 2002). The court held that while courts in Massachusetts have not distinguished between commercial and residential tenancies in applying the *Sutton Rule*, commercial tenancies present different considerations, for "[c]ommercial tenants tend to be more sophisticated about the terms of their leases and, unlike residential tenants, commercial tenants generally purchase liability insurance." Commercial tenants will be relieved of liability for negligently caused fire damage only if the lease reveals the parties so intended. Commercial tenants were not co-insureds under landlords' fire insurance policy and, therefore, tenants could be held liable in a subrogation action by the insurer.

**Michigan: Implied Co-Insureds.**

*New Hampshire Ins. Group v. Labombard*, 399 N.W.2d 527, 531 (Mich. App. 1986) (the fire insurer is not entitled, as subrogee, to bring an action against the tenant to recover for amounts paid to landlord for fire damage to rental premises caused by the tenant's negligence in absence of an express agreement between the landlord and tenant to the contrary).

**Breach of Contract Exception:** *Laurel Woods Apartments v. Roumayah*, 734 N.W.2d 217 (Mich. App. 2007). In *Roumayah*, the lease stated,

Tenant shall also be liable for any damages to the Premises... that are caused by the acts or omissions of Tenant or Tenant's guests.

The court held that the tenant was contractually liable for "any damage" caused by its acts, and that this was not limited to negligent acts. The landlord was allowed to pursue the tenant based on a breach of the lease agreement.

*American States Ins. Co. v. Hampton*, 2008 WL 4724279 (Mich. App. 2008) (extended this exception to permit subrogation claims).

**Minnesota: Case-by-Case.**

*Melrose Gates, LLC. v. Moua*, 2015 WL 1608845 (Minn. App. 2015) *aff'd in part and reversed in part* by 875 N.W.2d 814 (Minn. 2016). The Appellate Court found that the lease clearly reflected that it was reasonably anticipated by the parties that tenants would be liable for a property loss caused by the tenants and paid for by landlord's insurer. The Minnesota Supreme Court, while it held that the landlord and tenants reasonably expected that tenants would be liable for damage they negligently caused to their own unit, it also held that it was not reasonable to expect tenants would be liable for damage they caused to other property belonging to landlord, and thus landlord's insurer could maintain an action to recover amount paid to repair damage to the unit but not the amount paid to repair other units in the apartment complex or the common areas.

In *RAM Mut. Ins. Co. v. Rohde*, 820 N.W.2d 1 (Minn. 2012). The Minnesota Supreme Court rejected the implied co-insured doctrine. The court held that whether insurer could pursue subrogation action against tenant for water damage to property caused by tenant's negligence would be determined on case-by-case approach, based on reasonable expectations of landlord and tenant under facts of case, rejecting and abrogating earlier case law.

Minnesota has adopted the following statutory limitations to insurers subrogation actions:

§ 60A.41 Subrogation against insureds prohibited:

- (a) An insurance company providing insurance coverage or its reinsurer for that underlying insurance coverage may not proceed against its insured in a subrogation action where the loss was caused by the nonintentional acts of the insured.

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(b) An insurance company providing insurance coverage or its reinsurer for that underlying insurance coverage may not subrogate itself to the rights of its insured to proceed against another person if that other person is insured for the same loss, by the same company. This provision applies only if the loss was caused by the nonintentional acts of the person against whom subrogation is sought.

(c) This provision does not apply to or affect claims of a surety against its principal.

(d) Nothing in this section prevents an insurer from allocating the loss internally to the at-fault insured for purposes of underwriting, agency, and claims information.

### **Mississippi: Subrogation Permitted.**

*Paramount Ins. Co. v. Parker*, 112 So.2d 560 (Miss. 1959). There do not appear to be any restrictions on the ability of a landlord's insurer to pursue the tenant for subrogation as a result of damages paid by the insurer which were caused by the tenant.

### **Missouri: Case-by-Case.**

A tenant may be considered a "co-insured" under the insurance policy obtained by the landlord where it was clear that the parties intended to look only to insurance, rather than at each other, to pay damages caused by negligence. This intent must be determined from the four corners of the lease.

*Jos. A. Bank Clothiers, Inc. v. Brodsky*, 950 S.W.2d 297, 303 (Mos. App. 1997). The court found the parties' intent was to make tenant a co-insured from the lease's surrender clause. That clause provided that the tenant would surrender possession of the leased premises to landlord in good condition, "loss by fire, casualty, providence and deterioration excepted."

*Rock Springs Realty, Inc. v. Waid*, 392 S.W.2d 270, 274 (Mos. 1965). An insurer cannot subrogate against its own insured, since, by definition, subrogation arises only with respect to the insured's rights against third persons to whom the insurer owes no duty. Therefore, no right of subrogation arises against a person who holds the status of an additional insured, or against a tenant who is determined from the intent of the parties to be an implied co-insured.

### **Montana: Undecided.**

*Home Ins. Co. v. Pinski Bros., Inc.*, 500 P.2d 945 (Mont. 1971) (no right of subrogation can arise in favor of an insurer against its own insured since, by definition, subrogation exists only with respect to rights of insurer against third persons to whom insurer owes no duty).

### **Nebraska: Implied Co-Insureds.**

Absent an express agreement to the contrary in a lease, tenants and the landlord are implied co-insureds under the landlord's fire insurance policy; and the landlord's liability insurer is precluded from bringing a subrogation action against a negligent tenant. To subrogate against a tenant in Nebraska, it is necessary to show that the provisions of the lease and the expectations of the parties overcome the presumption that the tenant is an implied co-insured.

In *SFI, Ltd. P'ship 8 v. Carroll*, 851 N.W.2d 82 (Neb. 2014), the Nebraska Supreme Court held that the implied co-insured rule does not apply to uninsured losses. SFI owned an apartment complex and Michelle Carroll was a tenant under a residential lease agreement requiring Carroll to pay for repairs caused by her use of the unit and to maintain renter's insurance including "a personal liability coverage to a minimum of \$100,000.00." A fire occurred, and both the apartment and the surrounding building were damaged. SFI had \$10 million of coverage with a deductible of \$250,000. Still, SFI had over \$100,000 in uninsured losses. But, neither the total amount of damages nor the amount of any insurance recovery by SFI was included in the evidence. Carroll had renter's insurance and submitted a claim to her insurer, which paid \$1,500 for her damages under "Loss of Use Coverage." The court declined to extend the anti-subrogation rule to a landlord's uninsured losses caused by a tenant's negligence.

In *Beveridge v. Savage*, 830 N.W.2d 482 (Neb. 2013), the court said that the tenants reasonably expected that the owner of the building would provide fire insurance protection for the premises on behalf of both the tenant and

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landlord, and the provisions of the lease were insufficient to overcome the presumption that the Savages were co-insureds under the landlord's (Beveridge's) fire insurance policy. Because the Savages were co-insureds, no subrogation was allowed. The court found that there was no lease provision stating that Beveridge or his insurer had a right of subrogation against the Savages for damages caused by fire as a result of negligence. There was no provision which gave the tenant notice that he must obtain insurance coverage for the realty in the event his negligence caused damage to the house by fire. The lease provided "Renter's insurance is a 'contents' policy which covers tenant's possessions, such as furniture, appliances, personal belongings, and household goods" and required the tenants (Savages) to obtain a "liability and renter[']s insurance [policy] (\$100,000) at Tenant's expense." The court did not find an intent in these provisions overriding the implied co-insured status otherwise applicable.

The Nebraska Supreme Court in *Tri-Par Investments, L.L.C. v. Sousa*, 680 N.W.2d 190 (Neb. 2004) stated its rationale as follows:

... a pure *Sutton* approach has the benefit of providing legal certainty. For example, the *Sutton* rule prevents landlords from engaging in gamesmanship when drafting leases by providing the necessary incentive for them, if they so desire, to place express subrogation provisions in their leases. If such a provision is placed in their lease, tenants will be on notice that they need to purchase liability insurance. If such a provision is not included in their lease, insurers will pass the increased risk along to landlords in the form of higher premiums, and landlords, in turn, will pass along the higher premiums to tenants in the form of increased rent. As the court in *Sutton* did 30 years ago, we acknowledge that this is almost certainly the current commercial reality.

In addition, the *Sousa* court reasoned that the *Sutton Rule* prevented "the economic waste" that would occur "if each tenant in a multiunit dwelling or multiunit rental complex is required to insure the entire building against his or her own negligence."

#### **Nevada: Implied Co-Insureds.**

*Safeco Ins. Co. v. Capri*, 705 P.2d 659, 661 (Nev. 1985).

*Liberty Mutual Fire Ins. Co. v. Auto Spring Sup. Co.*, 59 Cal. App.3d 860 (1976). Absent an express provision in the lease establishing the tenant's liability for loss from negligently started fires, courts find that the premises insurance was obtained for the mutual benefit of both parties and that the tenant stands in the shoes of the insured landlord for the limited purpose of defeating a subrogation claim. It is not uncommon for the landlord to provide fire insurance on leased property. As a matter of sound business practice, the premium to be paid had to be considered in establishing the rental rate. Such premiums would be chargeable against the rent as an overhead or operating expense. Accordingly, the tenant paid the premium as part of the monthly rental. Courts consider it an undue hardship to require a tenant to insure against his own negligence, when he is paying, through his rent, for the fire insurance which covers the premises. A fire insurer is not entitled, as subrogee, to bring an action against a tenant to recover for amounts paid to the landlord for fire damage to rental premises caused by the tenant's negligence in absence of express agreement between the landlord and tenant to the contrary. The landlord and tenant are co-insureds under fire policy.

#### **New Hampshire: Implied Co-Insureds.**

*Cambridge Mut. Fire Ins. Co. v. Crete*, 846 A.2d 521 (N.H. 2004). Following the *Sutton Rule*, a landlord's insurer may not pursue a tenant for any damages caused by the tenant's negligence because the tenant is considered an implied co-insured. In addition, a landlord may not pursue the tenant for uninsured losses it sustains. The residential lease did not explicitly state that tenant was not considered coinsured of landlords under any fire insurance policy obtained by landlords nor did it explicitly require tenant to obtain his own fire insurance for leased premises.

#### **New Jersey: Subrogation Permitted.**

In *Ace American Ins. Co. v. American Medical Plumbing, Inc.* 2019 WL 1474065 (Superior Ct., App. Div. April 4, 2019) (construing the AIA A201 Waiver of Subrogation provisions), the court found in the AIA form a clear contractual waiver by the owner (Equinox Development Corporation) of its insurer's (Ace American Ins. Co.) subrogation right. In doing so it focused on the waiver "to the extent covered by insurance" language of the

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contract. One of the contractor's (Grace Construction Management Company LLC) work was for the "core and shell." Other contractors were performing work on the interior and furnishings. The core and shell contractor subcontracted the plumbing work to American Medical Plumbing, Inc. After the work under the American Medical Plumbing subcontract was completed, a water main failed and flooded the property (a health club). The Equinox's insurer paid \$1.2 million to Equinox for property damage to the property. Only \$8,000 was for damage to the core and shell and the balance was apparently for damage to internal construction, furnishings and equipment. Ace sued American claiming it was at fault for the water-main break and sought recovery of its payments to Equinox. ACE argued that its claim against American is not the kind that A201 subjects to a subrogation waiver. ACE contended that the subrogation waiver under section 11.3.7 has a spatial limit, applying only to claims for damage to the work itself but not adjacent property, as well as a temporal limit, applying only to claims arising before construction was complete. Since the bulk of the water damage affected not the health club's "core and shell" but its internal construction and furnishings, and since the claim here arose after the work was completed, ACE concluded that section 11.3.7 did not restrict it from suing American.

The court was called on to construe the following AIA provisions (authors added underlining and emphasis):

#### § 11.3 PROPERTY INSURANCE

§ 11.3.1 Unless otherwise provided, the Owner shall purchase and maintain, in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located, property insurance written on a builder's risk "all-risk" or equivalent policy form in the amount of the initial Contract Sum, plus value of subsequent Contract Modifications and cost of materials supplied or installed by others, comprising total value for the entire Project at the site on a replacement cost basis without optional deductibles. Such property insurance shall be maintained, unless otherwise provided in the Contract Documents or otherwise agreed in writing by all persons and entities who are beneficiaries of such insurance, until final payment has been made as provided in Section 9.10 or until no person or entity other than the Owner has an insurable interest in the property required by this Section 11.3 to be covered, whichever is later. This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.

§ 11.3.1.1 Property insurance shall be on an "all-risk" or equivalent policy form and shall include, without limitation, insurance against the perils of fire (with extended coverage) and physical loss or damage including, without duplication of coverage, theft, vandalism, malicious mischief, collapse, earthquake, flood, windstorm, falsework, testing and startup, temporary buildings and debris removal including demolition occasioned by enforcement of any applicable legal requirements, and shall cover reasonable compensation for Architect's and Contractor's services and expenses required as a result of such insured loss.

§ 11.3.5 If during the Project construction period the Owner insures properties, real or personal or both, at or adjacent to the site by property insurance under policies separate from those insuring the Project, or if after final payment property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period, the Owner shall waive all rights in accordance with the terms of Section 11.3.7 for damages caused by fire or other causes of loss covered by this separate property insurance. All separate policies shall provide this waiver of subrogation by endorsement or otherwise.

#### § 11.3.7 WAIVERS OF SUBROGATION

The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Section 11.3 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance

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held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

The court held that Ace's rights of subrogation were waived by the AIA provisions. The court stated

We are unpersuaded by these arguments. ACE misconstrues the basic structure of the two subrogation-waiver provisions. Section 11.3.7 applies the waiver to any insured damage, whether occurring during or after construction, whether to the Work, to the Project, or to other insured property – so long as the policy covering the damage falls within one of the two categories identified: “property insurance obtained pursuant to this Section 11.3” or “other property insurance applicable to the Work.”

Augmenting section 11.3.7, section 11.3.5 extends the waiver even to damage insured by a discrete policy. Thus, the waiver applies “[i]f during the Project construction period the Owner insures properties, real or personal or both, at or adjacent to the site by property insurance under policies separate from those insuring the Project.” (Emphasis added). The waiver also applies “if after final payment, property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period.” (Emphasis added).

ACE's blanket all-risk policy fell within both categories of coverage subject to section 11.3.7. Its builder's risk coverage constituted “property insurance obtained pursuant to this section 11.3” because it met the builder's risk insurance requirement. ... Moreover, inasmuch as the ACE policy exceeded the coverage required by section 11.3.1, it was also “other property insurance applicable to the Work.”

Since the all-risk coverage both satisfied A201's insurance requirement and was “applicable to the Work,” section 11.3.7 waived all claims for damages

“to the extent covered” by the policy. ... Thus, even where the damages are almost entirely non-Work-related, as they were here, the subrogation waiver applies, because the policy also covered the Work-related damages. Thus, even where the damages are almost entirely non-Work-related, as they were here, the subrogation waiver applies, because the policy also covered the Work-related damages.

*Zoppi v. Traurig*, 598 A.2d 19 (N.J. Super. 1990) (subrogation being permitted against negligent tenant. If the landlord has a claim against the tenant, existence of insurance obtained by the landlord, paid by the landlord, for the benefit of the landlord, does not exculpate the tenant from consequences of negligent conduct, absent express agreement to that effect).

**New Mexico: Case-by-Case.**

*Acquisito v. Joe R. Hahn Enterprises, Inc.*, 619 P.2d 1237 (N.M. 1980). Where the lease indicated that the parties failed to agree that one, or both, of them would carry fire insurance, and where there was no specific exculpatory language relieving the tenant from liability for negligence, the tenant was liable for negligently having caused a fire in the leased premises.

**New York: Subrogation Permitted.**

New York has rejected the implied co-insured rationale set forth in the “*Sutton Rule*”.

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*Indian Harbor Ins. Co. v. Dorit Baxter Skin Care, Inc.*, 430 F. Supp. 2d (S.D.N.Y. 2006). Waiver-of-subrogation clause in rental agreement extended to claims arising out of another's gross negligence, and thus insurer lacked subrogation claim against commercial tenant under New York law, seeking to recoup insurance proceeds paid to landlord for property damage allegedly incurred after fire on floor occupied by tenant. Waiver-of-subrogation clause waived right of either party to subrogate insurer to rights to recover for "any damage or loss occasioned by hazards compensated by insurance." The court held that this language encompassed all claims of any kind.

*Phoenix Ins. Co. v. Stamell*, 21 A.D.3d 118, 127, 796 N.Y.S.2d 772 (N.Y. App. Div. 2005) (college's insurer was entitled to bring a subrogation action against student who negligently set fire to her dormitory by burning a candle in her room and falling asleep

because the law as well as public policy considerations in New York support the right of Phoenix to maintain this subrogation action against defendant . . . . It is . . . well established in New York that "contracts may not be construed to exempt parties from the consequences of their own negligence in the absence of express language to that effect."

*Galante v. Hathaway Bakeries, Inc.* 6. A.D.2d 142, 176 N.Y.S.2d 87 (N.Y. 1958) (based partly on common law, lack of explicit language in the lease to the effect that the tenant was to make all necessary repairs to the interior of the demised premises reasonable wear and tear and damage by fire and unavoidable casualty excepted, and partly on Section 227 of the New York Real Property Law, tenant was relieved of its responsibility to make repairs to building following a fire only when the damage was not caused by tenant's fault, which meant tenant was not protected from liability for its own negligent acts when entire interior of premises was destroyed by a fire claimed to be the result of tenant's negligence).

#### **North Carolina: Subrogation Permitted.**

*Morrell v. Hardin Creek, Inc.* 2017 WL 3480543 (N.C. App. 2017). Even though the lease stated the parties "agree and discharge each other from all claims and liabilities arising from or caused by any hazard covered by insurance," the court ruled the lease did not explicitly state the parties contemplated waiving claims stemming from negligence.

*William F. Freeman, Inc. v. Adlerman Photo Co.*, 365 S.E.2d 183 (N.C. App. 1988).

*Winkler v. Appalachian Amusement Co.*, 238 N.C. 589, 79 S.E.2d 185, 190 (N.C. 1953). Upon paying a loss by fire, the insurer is entitled to subrogation to the rights of the insured against the third-party tortfeasor causing the loss, to the extent of the amount paid.

#### **North Dakota: Case-by-Case.**

A tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties to the lease as ascertained from the lease as a whole.

*Community Credit Union v. Homelvig*, 487 N.W.2d 601 (N.D. 1992).

*Agra-By-Products, Inc. v. Agway, Inc.* 347 N.W.2d 142 (N.D. 1984) (subrogation denied because lease required landlord to keep insurance and tenant to reimburse landlord for premiums).

#### **Ohio: Case-by-Case.**

A tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties to the lease as ascertained from the lease as a whole.

In *Cincinnati Ins. Co. v. Control Service Technology, Inc.* 677 N.E.2d 388 (Ohio App. 2011), the lease provided that the landlord agreed to restore the leased premises under certain conditions in the event of a fire or other casualty. The trial court found that this lease provision constituted "a waiver of any negligence on the part of CST." The Court of Appeals disagreed, finding that the provision was ambiguous and was not the type of waiver ordinarily relied upon to excuse a party from the results of the party's own negligence. The Court of Appeals also found that the parties' lease did not contain a surrender clause similar to the "rather explicit" surrender clause in the 1956 *Phil-Mar* case cited below as sufficient to constitute a waiver. It must be clear and apparent from the terms of the lease agreement, looked at as a whole,

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that the parties intended to relieve tenant from her common-law liability to landlord for negligence. If the landlord cannot sue, its insurer cannot sue. Also see *Cincinnati Ins. Co. v. Getter*, 958 N.E.2d 202 (Ohio App. 2011).

In *U.S. Fire Ins. Co. v. Phil-Mar Corp.*, 166 Ohio St. 85, 139 N.E.2d 330, 332 (Ohio 1956), the court denied subrogation because the lease provided that tenant would pay the possible increase in fire insurance premiums due to its activities. The court looked at the words expressed in the totality of the lease agreement to ascertain the intent of the parties. The court found that where a lease agreement contained (1) a surrender clause requiring the tenant to return possession of the leased premises to the landlord upon the expiration or termination of the lease, with said premises being “in as good condition and repair as the same shall be at the commencement of said term (loss by fire ... excepted),” and (2) a provision requiring the tenant to pay the landlord any additional premium charged for the fire insurance on the premises that resulted from the tenant’s occupancy, the landlord had relieved the tenant of liability for fire caused by the tenant’s negligence, and thus the landlord had no right of recovery against the tenant. The court, after “considering the lease as a whole,” found that it was apparent under the circumstances of the case that “the parties intended to relieve the lessee from its common-law liability to the landlord for loss by fire.”

#### **Oklahoma: Sutton Rule - Implied Co-Insured.**

*Sutton v. Jondahl*, 532 P.2d 478 (Okla. App. 1975) (known as the “***Sutton Rule***”). The court held that a fire insurer is not entitled, as subrogee, to bring an action against the tenant to recover for amounts paid to landlord by landlord’s insurer for fire damage to rental premises caused by the tenant’s negligence in absence of an express agreement between the landlord and tenant to the contrary. See discussion in the Article at [II.A.1](#) and at Endnote 27.

In *Hanover Ins. Co. v. Honeywell, Inc.*, 200 F. Supp.2d 1305 (N.D. Okla. 2002), the court relied upon *Sutton* and applied the implied coinsured approach to bar the insurer of the landlord’s subrogation action. The landlord owned a warehouse building and entered into a commercial lease agreement with a tenant. The terms of the lease agreement provided that the landlord agreed “to insure the Leased Premises for fire, casualty, and public liability.” The landlord purchased a policy from Hanover Insurance Company. The policy covered the building structure, as well as loss of business income for actual business losses not exceeding 12 consecutive months. The policy’s subrogation provision transferred the rights of the landlord to Hanover upon Hanover’s payment of a covered claim and also allowed the landlord to waive recovery against another party in writing prior to a loss to the covered property. After the warehouse building was destroyed by a fire, Hanover paid the landlord \$369,053.46 for damages to the structure and lost business income. Hanover subsequently brought a subrogation action against the tenant to recover the sums paid to the landlord. The tenant moved for summary judgment, asserting that, pursuant to *Sutton*, it was an implied coinsured under the landlord’s policy. Hanover argued that the lease’s indemnity provision constituted an “express agreement” to the contrary as contemplated by *Sutton*, and, therefore, it was entitled to pursue a subrogation claim against the tenant. The court disagreed with Hanover, noting that the indemnity provision did not refer to subrogation rights, nor did it contain any language placing the burden upon the tenant to buy its own insurance. Since the words “**subrogate**” or “**subrogation**” were not contained in the indemnity provision, or anywhere else in the lease, the indemnity provision was not an “express agreement” to the contrary as contemplated by *Sutton*.

*Morris Zeligson Props., LLC v. South E. Auto Trim, Inc.*, 99 P.3d 744 (Okla. Ct. Ap. 2004) (*Sutton Rule* applied in connection with a commercial lease to bar landlord’s insurer from subrogation against the tenant).

*Kansas City Fire and Marine Ins. Co. v. Rogers*, 871 P.2d 443 (Okla. Ct. App. Div. 3 1994) (the court found that the landlord and tenant were essentially co-insureds under landlord’s policy).

#### **Oregon: Anti-Sutton Approach.**

*Koch v. Spann*, 92 P.3d 146 (Or. App. 2004) CONTRACTUAL RISK TRANSFER at *Subrogation in Real Property Leases* (IRMI 2020) contains the following discussion of *Koch*:

The landlord owned a duplex and had a fire insurance policy issued by United Services Automobile Association (USAA). A tenant’s Christmas tree caught fire after the tenant decorated the tree with lit candles and sparklers, and the fire caused over \$215,000 in damage to the duplex. USAA paid the landlord for the loss and then brought a subrogation action in the landlord’s name against the

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tenant to recover the money it paid. The tenant argued that Oregon courts should adopt the implied coinsured rule expressed in Sutton and that he waived any negligence claim for fire loss under the terms of the lease. The court disagreed, finding that the lease agreement did not contain any language that could have been interpreted as a waiver of the insurer's right to pursue a subrogation claim against the tenant. The court also refused to adopt the Sutton rule, noting that such a rule would have been contrary to the presumption under Oregon law that contracts do not create immunity from liability. Moreover, the Sutton rule was also contrary to the Oregon Residential Landlord and Tenant Act, which provides that tenants may not negligently destroy, damage, or deface the leased premises. See Or. Rev. Stat. § 90.325(8) (2017). In addition, adopting the Sutton rule would be contrary to Oregon law because the Oregon Residential Landlord and Tenant Act allows landlords to recover damages and obtain injunctive relief for any noncompliance by the tenant with the rental agreement or the obligations set forth in Or. Rev. Stat. § 90.325 (including the subpart that obligates tenants not to negligently destroy or damage the leased premises). See Or. Rev. Stat. § 90.401 (2017). Accordingly, the tenant was not an implied coinsured under the landlord's policy, and the landlord's insurer was permitted to pursue subrogation against the tenant.

#### **Pennsylvania: Implied Co-Insured.**

In the 2019 Superior Court decision of *Joella v. Cole*, 221 A.3d 674 (Pa. Super. 2019), the landlord's (Joella) insurance company (Erie Insurance Exchange) filed a subrogation suit against a tenant (Cole) to recover for damages from a fire caused when Cole ran an extension cord across metal hinges to a microwave. Joella who carried insurance through Cole responded by arguing that the lease required Joella to maintain fire insurance and, therefore, she was an implied co-insured. The lease provided that the tenant had the right to maintain fire insurance to cover property not covered by the landlord's policy. Until this decision, *Remy* (see citation below) had been the only case discussing the issue. The trial court held that the reasonable expectation of the tenant was that she was an implied co-insured under the policy. On appeal, however, the Superior Court noted that while the Erie policy did not mention the tenant, it did say that the landlord would secure insurance for the building and the tenant had a right to get her own policy. Therefore, where the lease required the landlord to maintain insurance on the building, the reasonable expectations of the parties was that the tenant was an implied co-insured under the Erie policy and Erie could not pursue the tenant in subrogation.

*Remy v. Michael D's Carpet Outlets*, 571 A.2d 446 (Pa. Super. 1990), if the lease requires the landlord to provide fire insurance, the landlord's carrier cannot subrogate against the tenant. If the lease requires the tenant to obtain fire insurance, the landlord's carrier can subrogate.

#### **Rhode Island: Subrogation Permitted (Anti-Sutton Approach).**

*56 Assocs. ex. rel. Paolino v. Friedband*, 89 F.Supp.2d 189 (D.R.I. 2000). The court rejected the Sutton rule and permitted an insurer to bring a subrogation claim against the tenant absent an express or implied agreement precluding such a claim. The court rejected the presumption that the tenant is an implied coinsured if the lease (1) does not contain a provision requiring the landlord to maintain insurance for the benefit of the tenant or (2) does not contain a provision exculpating the tenant from liability caused by its own negligence or (3) does not contain any other clause that shifts the risk of loss caused by the tenant's negligence to the landlord. The *Friedband* court noted the Anti-Sutton Approach relies on the common law rule that a tenant should be liable for his or her negligence. The court noted that some courts also take the position that conferring implied coinsured status to a negligent tenant would circumvent public policy and also rely on statutes that do not permit tenants to escape liability for damages caused by their negligence.

#### **South Carolina: Subrogation Prohibited Except if Damage is Intentional or Recklessly Caused.**

§ 38-75-60. Cause of action by insurer against tenant.

Notwithstanding any other provision of law, no insurer has a cause of action against a tenant who causes damage to real or personal property leased by the landlord to the tenant when the insurer is liable to the landlord for the damages under an insurance contract between the landlord and the

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insurer, unless the damage is caused by the tenant intentionally or in reckless disregard of the rights of others.

**South Dakota: Case-by-Case.**

In *American Family Mut. Ins. Co. v. Auto-Owners Ins. Co.*, 757 N.W.2d 584 (S.D. 2008), the court held a better reasoned rule is one that recognizes the intent of the parties under contract law and the equitable underpinning of subrogation. Subrogation may be denied under the case-by-case approach if the lease expressly requires the landlord to maintain fire insurance or the lease exonerates a tenant from losses caused by a fire. The court noted that in the absence of an express agreement in the lease, the court avoids making assumptions and adopting fictions that are largely conjectural, if not patently illogical, and instead applies basic contract principles and gives proper credence to the equitable underpinning of the whole doctrine of subrogation.

**Tennessee: Implied Co-Insured.**

In *Dattel Family Limited Partnership v. Wintz* 250 S.W.3d 883 (Tenn. App. 2007), the court of appeals decided that the case-by-case review of the lease terms to determine the intent and expectations of the parties was not the best approach. The court stated that absent an express agreement to the contrary, a tenant should be considered a co-insured under the landlord's property casualty insurance policy, and the insurance carrier should therefore be precluded from asserting subrogation rights against the tenant. The court found

... a reasonable residential tenant, who has a mere possessory interest in a portion of the landlord's property, would likely expect his landlord to procure insurance on the entire rental property. Concomitantly, a reasonable residential landlord would not expect each of his tenants to independently purchase insurance to protect the entire building.... Accordingly, as reflected in the Sutton approach, all parties involved would reasonably expect a residential tenant to be considered a co-insured under the landlord's insurance policy unless the parties had expressly agreed otherwise.

*Tate v. Trialco Scrap, Inc.*, 745 F.Supp. 458 (M.D. Tenn. 1989, *aff'd*, 908 F.2d 6<sup>th</sup> Cir. 1990).

**Texas: Undecided.**

*Philadelphia Indem. Ins. Co. v. White*, 490 S.W.3d 468 (Tex. 2016). In an interesting case (argued by Jim Hemphill of the co-author's firm Graves Dougherty Heaton and Moody on behalf of the insurer), a case of first impression ("Today, we determine, as a matter of first impression, whether public policy embodied in the Texas Property Code precludes enforcement of a residential-lease provision imposing liability on a tenant for property losses resulting from "any other cause not due to [the landlord's] negligence or fault.""), the Texas Supreme Court was called on to determine a tenant's liability for damages arising out of a clothes dryer fire. The landlord's property insurer sued the tenant on a subrogation claim. The court was called upon to interpret the following provision in the apartment lease:

**DAMAGES AND REIMBURSEMENT.** You must promptly pay or reimburse us for loss, damage, consequential damages, government fines or charges, or cost of repairs or service in the apartment community due to: a violation of the Lease Contract or rules; improper use; negligence; *other conduct by you or your invitees, guests or occupants; or any other cause not due to [the landlord's] negligence or fault.* You will indemnify and hold us harmless from all liability arising from the conduct of you, your invitees, guests, or occupants, or our representatives who perform at your request services not contemplated in this Lease Contract. ***Unless the damage or wastewater stoppage is due to our negligence, we're not liable for—and you must pay for—repairs, replacements and damage to the following if occurring during the Lease Contract term or renewal period: (1) damage to doors, windows, or screens; (2) damage from windows or doors left open; and (3) damage from wastewater stoppages caused by improper objects in lines exclusively serving your apartment.*** (Emphasis appears in court's quotation of the provision.)

The procedural background to the court's decision is stated by the court as follows:

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At issue here is a tenant's responsibility for property damage sustained in a fire that originated in a tenant-owned clothes dryer stuffed with dry, unwashed bedding and pillows. A jury failed to find the tenant negligent in causing the fire, but held the tenant contractually liable for the loss under the terms of the lease agreement. The tenant filed a motion for judgment notwithstanding the verdict, asserting several grounds for avoiding enforcement of the contract. The trial court granted the tenant's motion without stating the basis and rendered a take-nothing judgment. In a split decision, the court of appeals affirmed, concluding the lease provision broadly and unambiguously shifts liability for repairs beyond legislatively authorized bounds and is, therefore, void and unenforceable. *Id.* at 471.

The supreme court ruled that

Though we agree the lease language does not expressly incorporate statutory carve-outs, we cannot say the contract is unenforceable on public-policy grounds because (1) the disputed lease provision can be enforced without contravening the Property Code and (2) the record here does not conclusively establish the factual predicate necessary to preclude its enforcement. We therefore affirm the court of appeals' judgment as to ambiguity, but reverse in part and render judgment that, on the record before the Court, the lease provision is not void and unenforceable. Because the court of appeals did not address the tenant's other defenses to enforcement, we remand the case to that court for further proceedings. *Id.* at 471.

*Finger v. Southern Refrigeration Services, Inc.*, 881 S.W.2d 890 (Tex. App. - Houston [1<sup>st</sup> Dist.] 1994). The insurer of a building that was damaged in fire brought action in name of the insured landlord (Finger) and the tenant (Monterrey House) to recover its subrogation interests from the contractor (Southern Refrigeration Services) that allegedly caused fire. The court held that the insurer that paid for repairs of fire damaged building had right to suit in name of the landlord, as named insured, to recover its subrogation interests against tenant's contractor, even though tenant paid for policy premiums.

*Interstate Fire Ins. Co. v. First Tape, Inc.*, 817 S.W.2d 142 (Tex. App. - Hou. [1<sup>st</sup> Dist.] 1991). Fifty State Survey: "An insurer of leased premises has no subrogation claim against the tenant for losses paid to the landlord when the leased premises are destroyed by a fire and the lease agreement, signed by the landlord and tenant, contains a limitation of liability clause which provided that neither party is liable for the insurable casualty damage to the leased premises, even when the tenant assigns its lease to the third party prior to fire. Landlords and tenants are free to contract between themselves that the tenant will pay for specific kinds of repair without a showing that the tenant caused the damage. Where a lease states that the tenant

must promptly pay or reimburse [landlord] for loss, damage, consequential damages, government fines or charges, or cost of repairs or service in the apartment community due to: a violation of the Lease Contract or rules; improper use; negligence; other conduct by you or your invitees, guests or occupants; or any other cause not due to [landlord's] negligence or fault,

it is subject to only one interpretation: that the tenant is required to pay the landlord for *any* damages to the apartment complex as long as the apartment complex was not at fault.

The provision in the lease agreement obligating the tenant to reimburse the landlord for all damage "not due to the landlord's negligence or fault" was not unenforceable *per se*, even though the provision was overly broad and could have encompassed scenarios in which the landlord would have had a non-waivable duty to repair under the Texas Property Code. A jury's finding that the tenant's negligence did not proximately cause damage from the fire did not support the finding that the tenant was not at fault or didn't cause the damage, as required for the tenant to establish that the landlord had a non-waivable duty to repair a condition that was not "caused by" the tenant. If there is sufficient evidence that the tenant's actions, even if not negligent, caused the fire, the lease provision is not unenforceable under the Texas Property Code as applied."

In *Wichita City Lines, Inc. v. Puckett*, 295 S.W.2d 894 (Tex. 1956), the Texas Supreme Court held that where the lease merely provided that the landlord agreed to carry fire and extended coverage insurance on the building, part of

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which was occupied by the landlord, there was no duty on the landlord to procure insurance for the benefit of the tenant, and the landlord's insurers were not precluded from obtaining a subrogated cause of action to recoup its policy proceeds on account of fire caused by the tenant's negligence. The court rejected the tenant's contention that the intent of the parties for including a covenant of the landlord to insure its own building (presumably the cost of which was built into the rent) was to exculpate the tenant for its own negligence.

**Utah: Implied Co-Insured.**

In *McEewan v. Mountain Land Support Corp.*, 116 P.3d 955 (Utah Ct. App. 2004), the court held that even if commercial lease were ambiguous as to the tenant's alleged obligation to obtain property insurance, the court would presume that the tenant was the co-insured of the landlord, thus barring a subrogation action by the landlord's insurer, as tenant would not have reasonably contemplated being held liable to landlord's insurer for fire damage to the premises. The court found that the lease did not include an express agreement that the tenant was required to obtain insurance to cover property damage caused by fire, and found that the insurer failed to introduce evidence to overcome presumption that the tenant was a co-insured.

*Fashion Place Inv. Ltd. v. Salt Lake Cnty.*, 776 P.2d 941 (Utah Ct. App. 1989).

*GNS Partnership v. Fullmer*, 873 P.2d 1157, 1162 (Utah Ct. App. 1954).

**Vermont: Case-by-Case.**

*Town of Stowe v. Stowe Theatre Guild*, 908 A.2d 447 (Vt. 2006); *Fairchild Square Co. v. Green Mountain Bagel Bakery, Inc.* 658 A.2d 31, 33 (Vt. 1995); *Lamoille Grain Co. v. St. Johnsbury & Lamoille Cty. R.R.*, 369 A.2d 1389, 1390 (Vt. 1976); *Union Mut. Fire Ins. Co. v. Joerg*, 824 A.2d 586, 590 (Vt. 2003).

**Virginia: Case-by-Case.**

*Monterey Corp. v. Hart*, 224 S.E.2d 142, 147 (Va. 1976) (a tenant's liability to the landlord's insurer for negligently causing a fire depends on the intent and reasonable expectations of the parties to the lease as ascertained from the lease as a whole).

**Washington: Implied Co-Insured.**

In *Trinity Universal Ins. Co. v. Cook*, 276 P.2d 372 (Wash. App. 2012), the court held that a tenant is a co-insured under its landlord's policy for the entire building, not only the unit she occupies. It also held that a tenant's spouse is a co-insured under the landlord's insurance policy. Inasmuch as the landlord was presumed to carry insurance for the tenant's benefit, absent express lease provision to the contrary, the tenant constituted an additional insured; thus, landlord's fire insurer had no subrogation rights against the tenant for loss to leased premises notwithstanding provision of lease agreement whereby the tenant agreed not to negligently destroy any part of premises.

*Community Ass'n Underwriters of Am., Inc. v. Kalles*, 259 P.3d 1154 (Wash. Ct. App. 2011).

*Cascade Trailer Court v. Beeson*, 749 P.2d 761 (Wash. App. 1988). A mutual understanding that a tenant will be relieved of liability for his own negligence may be inferred from provisions of the parties' lease. For example, the lease may expressly require the landlord to carry fire insurance covering the leased building, or it may prohibit the tenant from performing any acts which would raise the cost of insurance.

*Rizzuto v. Morris*, 592 P.2d 688 (Wash. App. 1979). The court noted that circumstances may also give rise to an inference that the parties have mutually understood that the landlord would provide the insurance.

**West Virginia: Subrogation Permitted.**

In *Farmers & Mechanics Mut. Ins. Co. v. Allen*, 778 S.E.2d 718 (W. Va. 2015), the court held that if the insurance contract unambiguously identifies the insured, then a court may not, by judicial construction, enlarge the coverage to include other individuals foreign to the insurer. To do so would be "patently unfair" since the insurer "has a right to choose whom it will or will not insure." The court ruled that a residential tenant is not an equitable "insured" under a landlord's homeowners' policy, unless specifically named in the policy. Therefore, a landlord's insurer can maintain a subrogation action against a tenant for the damages the insurer pays to the landlord following a fire or other destruction

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of the leased premises caused by a negligent tenant. The tenant is neither a named nor a definitional insured of the landlord's homeowners' insurance policy and is not an "insured" under the landlord's policy by the mere fact that the tenant may have an insurable interest in the leased property.

**Wisconsin: Subrogation Permitted.**

*Bennett v. West Bend Mut. Ins. Co.* 200 Wis. 2d 313, 546 N.W.2d 204 (Wis. App. 1996). The court held a tenant is precluded from claiming co-insured status under the landlord's fire insurance policy so as to avoid subrogation where the lease is silent as to fire insurance coverage.

In addition, Wis. Stat. § 704.07(3)(a) makes a tenant automatically liable to the landlord for damage to property caused by the tenant's negligence. Wis. Stat. § 704.07(3) Duty of Tenant:

(a) If the premises are damaged by the negligence or improper use of the premises by the tenant, the tenant must repair the damage and restore the appearance of the premises by redecorating. However, the landlord may elect to undertake the repair or redecoration, and in such case the tenant must reimburse the landlord for the reasonable cost thereof; the cost to the landlord is presumed reasonable unless proved otherwise by the tenant.

**Wyoming: Undecided.**

*Berger v. Teton Shadows, Inc.*, 820 P.2d 176 (Wyo. 1991), the Wyoming Supreme Court has intimated that it views a contractual provision to provide specific insurance as a waiver of subrogation rights with regard to the risk insured against.

<sup>27</sup> **Majority Rule: Implied Coinsured Negates Equitable Subrogation.** See FRIEDMAN ON LEASES (5<sup>th</sup> ed. 2011), § 9.11; and CONTRACTUAL RISK TRANSFER Subrogation in Real Property Leases - The Implied Coinsured Approach ("*Sutton Rule*") [International Risk Management, Inc. CONTRACTUAL RISK TRANSFER Subrogation in Real Property Leases last visited on line May 28, 2020 <https://www.irmi.com>] discussing cases supporting the results of the *Sutton Rule*. See Endnote **26** for cases following the *Sutton Rule* in the following jurisdictions: Alaska, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Maine, Michigan, Nebraska, New Hampshire, Ohio, Tennessee, Utah, Virginia, and Washington.

In circumstances where the lease does not contain a waiver of claims and a waiver of subrogation, the insurer's right to recover against a person other than its insured rests on the basic principle of law, *equitable subrogation*. A majority of courts follow the rule that a landlord's property insurer may not subrogate against a tenant whose negligence has caused damage to the landlord's property. These courts have found that the tenant is an *implied coinsured* under the insured's property insurance policy. Some of these courts have concluded that the landlord's agreement to procure property insurance covering the building implies an obligation by the landlord to insure the building for the benefit of both the landlord and the tenant. Others of these courts have reasoned that the tenant has indirectly paid for the insurance, either through rent or through expense pass through.

Supporting this approach is the generally accepted common law rule called the "**antisubrogation rule**" that an insurance company, having paid a loss to its named insured is barred against proceeding against its own "insured," since "by definition subrogation arises only with respect to rights of the insured against third persons to whom the insurer owns not duty." 16 Couch, INSURANCE 2d § 61:136. In *Stafford Metal Works, Inc. v. Cook Paint & Varnish Co.*, 418 F. Supp. 56 (N.D. Tex. 1976), the court summarized the policies behind the antisubrogation rule as follows.

1. The insurer that subrogates itself to its insured stands in the shoes of the insured and can take nothing by subrogation but the rights of the insured. Since a person cannot bring an action against himself for damages, neither can an insurer who would subrogate itself to that person.
2. To allow subrogation against its own insured would manipulate the concept of risk and risk management in that the insurer, by charging premiums, assumes the risk of the negligence of the insured.

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3. The fiduciary relationship between insurer and insured is fraught with conflicting interests, and allowing the insurer to sue its own insured would upset the tenuous relationship.

4. Because of the fiduciary relationship, the insurer would be able to secure information from the insured under the guise of policy provisions which could be available for later use in a subrogation action against the insured.

5. The right of the insurer to sue its own insured would amount to judicial sanction of a breach by the insurer of the terms of the insurance policy.

**28 Case-by-Case Rule in Illinois as to Whether Subrogation is Permitted.** See e.g., *Stein v. Yarnell-Todd Chevrolet, Inc.*, 241 N.E.2d 439, 41 Ill. 2d 32 (Ill. 1968). A commercial lease obligated the tenant to procure and maintain certain types of insurance (e.g., plate glass damage, damage by boiler or boiler explosion, public liability and “damage or injury to employees of the lessee.” 241 N.E.2d 442. The lease was silent on whether the landlord was obligated to carry any insurance, but did obligate tenant to reimburse the landlord for any premium increases for the landlord’s insurance policy and to cease any activity that would “invalidate any insurance policy maintained on the building or leased premises” which meant parties intended the landlord would carry insurance on the real estate. *Id.* In addition, the lease specified the tenant was to “return the premises and all leasehold improvements and fixtures therein in as good condition as when lessee took possession, ordinary wear and tear or damage by fire or other casualty beyond lessee’s control excepted.” *Id.* at 440. Accordingly, based on “the lease as a whole, we judge that the parties manifested a pervading intention that the lessee was not to be liable for damage through fire resulting through the lessee’s negligence.” *Id.* at 443.

See also *Nationwide Mut. Fire Ins. Co. v. T&N Master Builder & Renovators*, 959 N.E.2d 201, 355 Ill. Dec. 173, 2011 IL App (2d) 101143 (Ill. App. 2011) (same anti-subrogation rule applicable to residential leases applies to commercial lease where clause holding commercial holdover tenant liable for damages sustained to premises while in tenant’s possession did not apply to damages caused by fire because lease surrender clause specifically excepted losses by fire).

**29 California, Florida and Indiana Case-by-Case Rule as to Whether Subrogation is Permitted.** See Endnote **26** and **28** for discussions of cases employing the “case-by-case approach”. 16 COUCH ON INSURANCE § 224:65. Relationship Alone Insufficient to Create Coinsured Status (3<sup>rd</sup> Ed. 12/2019) sets forth the following “food for thought” as to the complexity introduced by the case-by-case approach:

...some courts adhere to the view that the trier of fact must, on a case-by-case basis, focus on the terms of the lease agreement itself to determine what the reasonable expectations of parties were as to who should bear the risk of loss for fire damage to the leased premises.

**Observation:**

The concept of reasonable expectations is extremely difficult to prove. Such items as written documentation and oral conversations pertaining to the formation of the contract must be considered. However, the practitioner must also consider the application of the evidentiary rules such as the best evidence rule, hearsay, and whether the contract can be interpreted and defined by oral testimony.

The following is a discussion of three recent cases from California, Florida and Indiana.

**California.** In the recent case, *Western Heritage Ins. Co. v. Frances Todd, Inc.*, 33 Cal. App.5<sup>th</sup> 976 (Ct. App., 1<sup>st</sup> Dist., Div. 5 2019), the court was faced with determining whether a condominium association insurer could subrogate against a negligent tenant of a condo owner for a fire loss. The property insurer issued property insurance to the condominium association pursuant to the following provisions in the condominium CC & Rs referenced by the court:

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Article 13.1 of the Declaration of Codes, Covenants and Restrictions (CC & Rs) applicable to the property requires the Association to “obtain and maintain a master or blanket policy of all risk property insurance coverage for all Improvements within the Project, insuring against loss or damage by fire or other casualty. ... The policy shall name as insured the Association, the Owners and all Mortgagees of record, as their respective interests may appear.” Article 13.3 provides in part, “Any insurance maintained by the Association shall contain [a] ‘waiver of subrogation’ as to the Association, its officers, Owners and the occupants of the Units and Mortgagees. ...” Article 13.4 prohibits an individual owner from obtaining fire insurance while allowing an owner to obtain individual liability insurance. Article 3.1 requires that all “occupants and tenants” comply with the CC & Rs.

The court noted that the lease between the condominium owner and the tenant contained the following provisions (reformatted by author):

Paragraph 5 of the Lease provided, “Lessee shall not commit waste, nor carry on any activity which would destroy or impair the quiet enjoyment of other lessees in the building of which the Premises form a part.” Paragraph 6 required the Lessee to keep the Premises in good repair. Paragraph 8(A) required the Lessee to “keep in force a public *liability* insurance policy covering the leased premises, including parking areas, if any, included in this Lease, insuring Lessee and naming Lessor as an additional insured. ... Said insurance policy shall have minimum limits of coverage of \$ 1,000,000 in the aggregate.” (Italics added.) The Lease did not specify which party (Lessor or Lessee) would carry *fire* insurance.

Paragraph 9(B) of the Lease, entitled “Lessor’s Right to Recover Damage(s),” provided, “Such efforts as Lessor may make to mitigate damages caused by Lessee’s breach of this Lease shall not constitute a waiver of Lessor’s right to recover damages against Lessee hereunder. Nor shall anything herein contained affect Lessor’s right to indemnification against Lessee for any liability arising prior to the termination of this Lease for personal injuries or property damage resulting from the acts or omissions of Lessee, and Lessee hereby agrees to indemnify and hold Lessor harmless from any such injuries or property damages ... except for damages occasioned by Lessor’s intentional or grossly negligent acts.”

Paragraph 11 of the Lease provided in relevant part, “Lessee agrees to surrender the Premises at the termination of the tenancy herein created, in substantially the same condition as they were on the Commencement Date, reasonable wear and tear, casualty, and any alterations, improvements, and/or additions which are the property of Lessor under Paragraph 7 excepted.” Paragraph 19 allowed either party to terminate the lease when damage due to fire, other casualty or eminent domain rendered ten percent or more of the property “untenantable.” In the event the fire, other casualty or taking rendered less than ten percent of the property untenable, “the Lessor shall proceed to repair the Premises and/or the building and/or the property of which the Premises are a part to the extent of any insurance proceeds received on account of a Casualty. ...”

The court held (reformatted by author):

In this case, we conclude the Western Heritage policy was maintained for defendants’ benefit and that summary judgment was properly granted in their favor.

First, the Lease in this case required defendants to obtain only liability insurance, not fire insurance. The implication was that fire insurance would be carried by the lessor, de Carion. William R. de Carion was an additional named insured on the insurance policy purchased by the Association, as the CC & Rs governing the property required.

Second, owners such as de Carion were prohibited by the CC & Rs from purchasing an individual fire policy, as were “occupants” and “tenants” of the premises to whom the CC & Rs applied. (See

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Policy, [¶] [¶] 3.1, 13.4.) Defendants could not, therefore, purchase their own first-party fire insurance for the structure (a structure in which they held no ownership interest).

Third, the yield-up clause in this case provided that defendants, as lessees, agreed to “surrender the Premises at the termination of the tenancy herein created, in substantially the same condition as they were on the Commencement Date, reasonable wear and tear, *casualty*, and any alterations, improvements, and/or additions which are the property of the Lessor under Paragraph 7 excepted.” (Lease, [¶] 11, italics added.) “Casualty” includes damage from fire.

... But whether or not de Carion was named as an insured under the first party fire provisions, the CC & Rs, which formed a contract between de Carion and the Association (citations omitted), contemplated that he would be. They also provided that in any such policy, the Association secure a waiver of any right the insurance company might have to a subrogation action against the owners or tenants of the project. It would be inequitable under these circumstances to treat the Association as the sole insured for purposes of Western Heritage’s right to bring a subrogation action to recover amounts paid under its fire policy.

**Florida.** The most recent Florida case cited in that article is *Zurich American Ins. Co. v. Puccini, LLC dba Five Napkin Burger*, 271 So.3d 1079 (Fla. App. - Third Dist. 2019) , review denied, 2019 WL 4266002 (Fla. 2019), which involved a \$2.1 million subrogation claim by the landlord’s insurer (Zurich American Ins. Co.) against a restaurant tenant (Five Napkin Burger) that had argued it was an implied coinsured under the landlord’s property insurance policy. Applying the case-by-case rule adopted in Florida, and based on the language of the lease, the court held the tenant would bear the risk of loss due to damage to the premises caused by its negligence, the tenant was not an implied coinsured under the landlord’s property policy, and the landlord’s insurance company could proceed with its subrogation action against the tenant. The court held that the commercial tenant was not an implied co-insured with landlord under landlord’s fire insurance policy, and therefore, landlord’s insurer could proceed with its subrogation action against tenant for fire damage to building allegedly caused by tenant’s negligence, where the lease held tenant responsible for all repairs and damages if the premises were destroyed by a fire caused by tenant, the lease contained unilateral provisions that waived the landlord’s liability and the tenant’s right to make a claim against the landlord, and the lease placed the burden on the tenant to procure and maintain insurance and to name the landlord as an additional insured, even though the lease required the tenant to pay, in the form of rent, 70% of landlord’s operating expenses including premiums.

The court found that it was clear from the following lease provisions that the parties did not intend to shift the risk of loss for damage caused by the tenant's negligence to Zurich:

(1) Rent Not Abated for Tenant Negligently Caused Fires.

Paragraph 41 provided that "rent shall not be abated and Tenant shall be fully responsible for all repairs and damages if Premises are partially or totally destroyed by fire or any other casualty caused by Tenant or its agents." The court noted "Not only does Paragraph 41 not exculpate Tenant for its own negligence, it expressly holds it liable."

(2) Exception to Landlord's Structural Repair Obligation for Repairs Due to Tenant's Negligence.

Paragraph 33 eliminated Landlord's duty to make repairs to the "structural aspects and elements of the Building," if such repairs were "occasioned by any intentional or negligent act of Tenant, its agents, or its employees."

(3) Unilateral Provisions Expressly Waiving Landlord Liability.

Paragraph 9 waived liability of Landlord for "any loss or damage to any of Tenant's personal property or Premises unless directly caused by the gross negligence or willful misconduct of Landlord ... nor shall Landlord be liable for ... damages incurred or suffered by the Tenant ... or others occasioned by ... fire...." The court reasoned that by the lease's "plain language" Paragraph 9 shifted the risk of loss from the Landlord to the Tenant, absent gross negligence or willful misconduct on Landlord's part.

(4) Tenant Indemnified Landlord for all Damages Arising Out of Occurrences In the Premises.

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Paragraph 24 required Tenant to indemnify Landlord "from any and all ... damages ... arising from or out of any occurrence in or upon the Premises ...."

(5) Tenant Indemnified Landlord for all Costs Resulting from Tenant's Failure to Properly Maintain the Premises.

Paragraph 31 required Tenant to be responsible for and to indemnify Landlord for any "costs ... relating to such damages ... resulting from Tenant's failure to properly maintain the Premises ...."

(6) Tenant Required to Insure or Self-Insure its Own Losses; Waiver of Recovery for Losses for Which Tenant Should Have Maintained Insurance.

Paragraph 25 of the lease placed burden on Tenant to procure and maintain insurance for its own benefit and to name Landlord as an additional insured, rather than requiring Landlord to maintain insurance for the benefit of Tenant. Paragraph 25 provides:

25. INSURED LOSS OR DAMAGE; In any event of loss or damage to the Building, the Premises and/or any contents, each party shall first exhaust its own insurance coverage before making any claim against the other party. As Tenant is obligated to maintain insurance to fully cover all of its losses, in the event Tenant sustains a loss not fully covered by its own insurance, Tenant acknowledges that it is self-insured for any uncovered loss; Tenant expressly waives the right to make any claim against the Landlord or seek recovery of any damages from the Landlord or its insurance company arising out of any loss or incident for which the Tenant should have maintained its own insurance.

(7) Tenant Required to Maintain Property Insurance and Liability Insurance for Property Damage Naming Landlord as Additional Insured; Tenant Indemnifies Landlord for Claims for Which Tenant Insurable.

Paragraph 26 required Tenant to maintain

(a) Fire/Windstorm/Property Insurance with extended coverage endorsement on Tenant's fixtures, equipment, furnishings and other contents of the Premises, for the full replacement cost of said items; and (b) Comprehensive Commercial / Public Liability Insurance ... sufficient to protect against liability for damage claims ... arising out of accidents occurring in or around the Premises in a minimum of ... \$1,000,000.00 for property damage.... Such insurance policies shall provide coverage for Landlord's contingent liability on such claims or losses, and shall name Landlord as an additional insured party.... Tenant shall maintain sufficient insurance to fully protect Tenant from all losses and damages; Tenant indemnifies and saves Landlord harmless for any claim for which Tenant was insurable."

(8) Operating Cost Rent Did Not Obligate Landlord to Insure Tenant.

Paragraph 45 required Tenant to pay as additional rent 70% of Landlord's operating expenses, including insurance premiums. The court rejected Tenant's argument that by paying the majority of the cost of the property insurance maintained by Landlord, Tenant was to be protected by that insurance, and that there was an implied waiver of subrogation. The court found that nothing in the lease explicitly required Landlord to purchase property insurance or to name Tenant as an insured under any insurance policy procured by Landlord.

**Indiana.** Indiana first adopted the case-by-case rule for determining whether a landlord's insurer could bring subrogation action against a negligent tenant for damage to the leased premises in 2014 in *LBM Realty, LLC v. Mannia*, 19 N.E.3d 379 (Ind. App. 2014). In that case, which contains an extensive summary of the so-called "Sutton Rule" (the majority rule) and the minority rule, the court concluded the landlord's insurance company was entitled to bring a subrogation action against a residential apartment tenant who had caused a fire for damages to the

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unit she leased, but because there was no clear and enforceable provision in the lease that would have put the tenant on notice she would be responsible for damage to areas of the multi-unit apartment building outside of her leased premises, the insurance company would not be able to seek recovery for those amounts.

In a more recent case, still applying the case-by-case approach, the Indiana Court of Appeals distinguished the holding in the *LBM Realty* case. See *Youell v. Cincinnati Insurance Co.*, 117 N.E.3d 639 (Ind. Ct. App. December 2018). The *Youell* case involved a subrogation claim by landlord's insurer against a commercial tenant. When the building was damaged by a fire, the landlord's insurer paid \$227,653 to repair the damage. The tenant filed a motion for judgment on the pleadings in the case, arguing the insurer had no right to a subrogation claim. The court agreed, holding

the Commercial Lease Agreement unambiguously provides that Landlord would insure the building and Tenant would insure its personal property inside the building. . . . Landlord and Tenant's agreement to insure was thus an agreement to provide both parties with the benefits of the insurance and expressly allocated the risk of loss in case of fire to insurance. 117 N.E.3d at 642.

The court was able to distinguish the *Youell* case because the in *LBM Realty* the

lease did not require the landlord to maintain property insurance and only recommended that the tenant obtain renter's insurance; as a result, the parties' expectations with respect to liability for damage to the leased premises was unknown. 117 N.E.3d at 643.

<sup>30</sup> **Tenant Damaged by Landlord.** See Ann Peldo Cargile, *Implied Waivers of Subrogation in Leases*, 12 PROB. & PROP. 22, 27 (1998).

<sup>31</sup> **Minority Rule: *Anti-Sutton Rule Approach - No Implication of Coinsured Status.*** A minority of courts have rejected the *Sutton* Rule and permit an insurer to bring a subrogation claim against the tenant absent an express or implied agreement precluding such a claim. These courts reject the presumption that the tenant is an implied coinsured if the lease

- (1) does not contain a provision requiring the landlord to maintain insurance for the benefit of the tenant,
- (2) does not contain a provision exculpating the tenant from liability caused by its own negligence, or
- (3) does not contain any other clause that shifts the risk of loss caused by the tenant's negligence to the landlord.

Courts employing the anti-Sutton approach rely on the common law rule that a tenant should be liable for his or her negligence. Some also take the position that conferring implied coinsured status to a negligent tenant would circumvent public policy and also rely on statutes that do not permit tenants to escape liability for damages caused by their negligence.

See FRIEDMAN ON LEASES (5th ed. 2011), § 9.12 *No Implication of Coinsured Status Unless Explicitly and Unambiguously Stated Otherwise in the Lease*; and CONTRACTUAL RISK TRANSFER *Subrogation in Real Property Leases - The Anti-Sutton Approach (Subrogation Permitted)* [International Risk Management, Inc. last visited on line May 28, 2020 <https://www.irmi.com/online/crt/ch005/1105f000/al05f010.aspx>] discussing cases for the Anti-Sutton Rule Approach. See Endnote 26 for discussions of cases in Iowa (*Neubauer*); New Jersey (*Ace American*); Oregon (*Koch*); Rhode Island (*Paolino*). See the following commentator's criticism of the *Sutton Rule*, J. Appleman, INSURANCE LAW AND PRACTICE § 4055, at 78 (1991 Supp.):

*Sutton*, the leading modern case denying subrogation of lessees, cites no cases for the proposition that the lessee is a co-insured of the lessor, comparable to a permissive user under an auto insurance policy. Contrary to the court's statements, the fact both parties had insurable interests does not make them co-insureds. The insurer has a right to choose whom it will insure and it did not choose to insure the lessees, and under this holding the lessee could have sued the insurer for loss due to damage to the realty, e.g. loss of use if policy provides such coverage. Cases following

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*Sutton*, however, have at least impliedly restricted the co-insurance relationship to one limited solely to the purpose of prohibiting subrogation.

**New York** also follows the minority rule, and allows the insurer to bring a subrogation claim against the tenant absent an express agreement to the contrary in the lease.

*See, Galante v. Hathaway Bakeries, Inc.*, 6 A.D.2d 142, 176 N.Y.S.2d 87, 92 (N.Y. 1958), based partly on common law, lack of explicit language in the lease to the effect that the tenant was to make all necessary repairs to the interior of the demised premises reasonable wear and tear and damage by fire and unavoidable casualty excepted, and partly on Section 227 of the New York Real Property Law, tenant was relieved of its responsibility to make repairs to building following a fire only when the damage was not caused by tenant's fault, which meant tenant was not protected from liability for its own negligent acts when entire interior of premises was destroyed by a fire claimed to be the result of tenant's negligence).

*See also Phoenix Ins. Co. v. Stamell*, 21 A.D.3d 118, 127, 796 N.Y.S.2d 772 (N.Y. App. Div. 2005), college's insurer was entitled to bring a subrogation action against student who negligently set fire to her dormitory by burning a candle in her room and falling asleep because the law as well as public policy considerations in New York support the right of Phoenix to maintain this subrogation action against defendant.

It is . . . well established in New York that "contracts may not be construed to exempt parties from the consequences of their own negligence in the absence of express language to that effect."

<sup>32</sup> **Subrogation if No Waiver of Recovery.** *See* FRIEDMAN ON LEASES, § 9.8 Fault of Landlord or Tenant - Subrogation of Insurer 567, 572 n. 18 (4th ed. 1997).

<sup>33</sup> **Property Policies and Negligence.** *See International Co. v. Medical-Professional Building of Corpus Christi*, 405 S.W.2d 867 (Tex. Civ. App.—Corpus Christi 1966, writ ref'd n.r.e.)—lessee waived in advance any claims for damages caused by landlord's negligent failure to maintain boilers in the portion of the leased premises which was under landlord's control "to extent that lessee was compensated by insurance for such damages."

*See also Williams v. Advanced Technology Ctr., Inc.*, 537 S.W.2d 531 (Tex. App. Eastland 1976, writ ref'd n.r.e.)—subrogation suit brought against tenant by landlord's fire insurance carrier was barred by landlord's waiver of subrogation clause contained in the lease, notwithstanding tenant's breach of the lease by permitting the leased premises to be used for an extra hazardous operation.

<sup>34</sup> **Alternative - Both Parties as Named Insured?** Charles W. Trainor, updating a 1995 Article by Sanford J. Liebshutz and Scott B. Osborne, *Subrogation-the Untold Story*, notes

...such a concept presents other problems, such as determining who has the right to receive the insurance proceeds, who has the right to settle the claims (often dependent on who is the first named insured) and other administrative problems. (FN omitted) It is not uncommon for landlords with limited property, or tenants with limited locations, to add the other party as an additional insured on their respective policies. However, it is difficult to negotiate such a provision with a landlord who has multiple properties (with possibly hundreds of tenants) insured under one blanket insurance policy. The same is true for a tenant with a blanket policy covering numerous locations with different landlords.

Also see, Charles W. Trainor, *Selected Insurance Provisions in Work Letters*, American College of Real Estate Lawyers, Tucson, Arizona (March 18, 2005) for further good discussion of these concept in the context of tenant improvement work letters. This article can be found on-line at [https://cdn.ymaws.com/acrel.site-ym.com/resource/collection/674138B4-8B21-4F99-90B3-AA109D31C1FC/Trainor-S05-Insurance\\_Article.pdf](https://cdn.ymaws.com/acrel.site-ym.com/resource/collection/674138B4-8B21-4F99-90B3-AA109D31C1FC/Trainor-S05-Insurance_Article.pdf) (last visited May 28, 2020).

<sup>35</sup> **Unintended Protecting Party.** For example, in *Freeman v. Alderman Photo Company*, 365 S.E.2d 183 (N.C. Ct. App. 1988) (citing *Winkler v. Appalachian Amusement Co.*, 79 S.E.2d 185 (N. C. 1953), the lease required that

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all insurance carried by landlord and tenant "provide a waiver of subrogation against the other party". The lease also required the tenant to insure its personal property. The tenant's personal property was damaged due to landlord's negligence. The tenant sued the landlord for damages. The court concluded that the contractual waiver of subrogation was not an express waiver of liability for negligence, and held that the tenant had the right to bring suit against the landlord for damages to tenant's personal property.

<sup>36</sup> **"Other Insurance" Clauses in the ISO CGL Policy.** Under Section IV.4 of the **ISO CG 00 01 04 13** Commercial General Liability Coverage Form, if an insured (which includes a landlord added as an additional insured under an ISO form of Additional Insured Endorsement) has available to it "other valid and collectible insurance" (called in the industry "**other insurance**"), the insurance under the insured's policy (if it is fire insurance covering the premises leased to the insured) is excess. An "other insurance" provision means the tenant's liability insurance will not cover damage to the landlord's property (caused by the tenant's negligence and for which there has been no waiver of the right of recovery); Section IV.4 does state it will cover any amount that exceeds the total amount the other insurance (*i.e.*, the landlord's property insurance policy) would pay for the damage, plus the deductible or self-insured amounts under the landlord's property insurance policy.

<sup>37</sup> **No Release by Protecting Party; and No Waiver of Subrogation.** See discussion of Common Law at Part II of the Article.

<sup>38</sup> **Contractual Obligation to Obtain a Waiver of Subrogation; But No Waiver of Subrogation by Insurer and No Waiver of Recovery by Protected Party.** There is a split of authority in circumstances where the lease contains a contractual waiver of the insurer's subrogation, but the insurer has not waived subrogation in its policy. See *Continental Ins. Co. v. Boraie*, 672 A.2d 274, 277 (N.J. Super. Ct. Law Div. 1995) holding that a provision in a lease obligating the tenant to obtain insurance containing a waiver of subrogation prohibited the insurer from subrogating against the negligent landlord. The lease provided

All such insurance policies maintained by the Tenant, and all policies of insurance maintained by the Landlord with respect to the Demised Premises or any property of which the Demised Premises are a part shall contain provisions for waiver of subrogation against the Landlord or the Tenant, as the case may be.

See line of contra authority cited in *Boraie* at 277, including *Zurich Am. Ins. Co. v. Eckert*, 770 F. Supp. 269 (E.D. Pa. 1991) holding that a landlord's promise to have its insurance policy contain waivers of subrogation did not bar landlord's insurer from pursuing the insurer's subrogation right under its policy against the negligent tenant; insurer was not shown to be aware of the lease provision when it issued its policy. In *Zurich* both landlord and tenant had property insurance, and each promised to obtain waivers of subrogation from their insurer, but do not. The lease between landlord (Wissahickon) and tenant (Eckert) provided

Lessor and Lessee hereby agree that all insurance policies which each of them shall carry to insure the demised premises and the contents therein against casualty loss, and all liability policies which they shall carry pertaining to the use and occupancy of the demised premises shall contain waivers of the right of subrogation against Lessor and Lessee herein, their heirs, administrators, successors, and assigns.

The court noted that the lease between Wissahickon and Eckert did not contain a release of Eckert's liability for damages caused by his negligence. *Id.* at 272. The court also noted

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The fact that the insurance policy issued by Zurich to Wissahickon became effective after the date of the lease between Mr. Eckert and Wissahickon should not bar Zurich's right to subrogation unless Zurich was aware or should have been aware that Wissahickon had agreed with its tenant that its insurance policy would "contain waivers of the right of subrogation against lessor and lessee. *Id.* at 272.

<sup>39</sup> **Pretzel.** See Beat Steiner, *Three (Or More) Pretzels in a Lease Sorting Through Intertwined Provisions*, 32 PROBATE & PROPERTY 4, pp. 46-51 (July/August 2018):

Pretzels are distinguished by their unique shape. Wikipedia notes that "[t]he traditional pretzel shape is a distinctive nonsymmetrical form, with the ends of a long strip of dough intertwined and then twisted back into itself in a certain way (creating 'a pretzel loop')." Wikipedia, *Pretzel*, Wikipedia.com (last visited Apr. 25, 2018), <https://en.wikipedia.org/wiki/Pretzel>. The pretzel provides a useful image, which evokes how some lease clauses are intertwined.

Certain provisions of a lease are inherently intertwined. In a badly drafted lease, intertwined clauses are drafted as if they stand alone, and, as a consequence, sometimes conflict. In a well-drafted lease, the intertwined provisions work together. When intertwined provisions conflict, they read like a mental pretzel—the clauses are twisted back into one another as in a pretzel loop.

<sup>40</sup> **Damage Liability Covenant vs. Waiver of Claims and Insured Risk.** This provision is part of ¶ **D.4** (Release of Claims/Subrogation) in the Retail Lease, **Form 1** in the Appendix of Forms.

<sup>41</sup> **Released Party's Negligence Included in Release of Claims.** This provision is part of ¶ **D.4** (Release of Claims/Subrogation) in the Retail Lease, **Form 1** in the Appendix of Forms.

<sup>42</sup> **Released Party's Negligence Included in Release of Claims.** This provision is part of ¶ **D.4** (Release of Claims/Subrogation) in the Retail Lease, **Form 1** in the Appendix of Forms.

<sup>43</sup> **Waiver of Claims "Coverable by Insurance".** Norman W. Gutmacher, *Waiver of Subrogation Tips and Issues*, ACREL News (2016).

<sup>44</sup> **Obligation to Insure vs. Obligation to Indemnify.** See, e.g., *Clarendon America Ins. Co. v. Prime Group Realty Services, Inc.*, 907 N.E.2d 6, 389 Ill. App. 3d 724 (1<sup>st</sup> Dist. App. 2009). Consistent with the insurance requirements in the lease, the tenant procured an insurance policy from Clarendon America Insurance Company that listed the landlord as an additional insured. However, the policy included an endorsement that excluded coverage for any additional insured for its own acts or omissions. The underlying claim that led to the opinion involved an injury suffered by an employee of the tenant while that employee was on the rooftop of the landlord's building after he repaired the HVAC system on the roof of the building. Clarendon agreed to defend the landlord under a reservation of rights "to the extent that it determined that [the tenant's employee's] injuries are the result of [landlord's] negligence because the landlord was named as an additional insured under the tenant's CGL policy." The landlord filed a third party complaint against the tenant, claiming the tenant had failed to procure the CGL insurance required under the lease. The landlord appealed a motion for summary judgment in favor of the tenant on the issue of whether the tenant had breached its obligations under the lease because it had no obligation to insure or indemnify the landlord against the landlord's own negligence.

The court noted that the obligation to insure is different from an obligation to indemnify because the obligation to indemnify requires the party agreeing to indemnify the other "to assume all responsibility for any injuries or damages" whereas a promise to insure requires that party to agree to "procure insurance and pay premiums" citing the *Sears* case discussed in Part V.C (Best Practice Tips - Importance of Reviewing Insurance Policies Against Indemnification Obligations). "A promise to insure relieves the promisor of responsibility" in the event of an injury or damages once the insurance is obtained." *Sears, Roebuck and Co. v. Charwil Associates Ltd. Partnership*, 864 N.E.2d 869, 875 (1<sup>st</sup> Dist. 2007).

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Although the court acknowledged the premises may include areas in addition to leased areas, the *Clarendon* court held that the tenant had satisfied its obligation to procure insurance for the premises as defined in the lease, which included a specifically defined space in the plaza level and basement level of the building that was shown in a plan attached to the lease. The court also noted that the insurance provision obligated the tenant to procure insurance regardless of whether the landlord or the tenant was negligent. Nevertheless, the provision was held to be valid and enforceable. Why? Because a waiver of claims coupled with an indemnity provision must prohibit the landlord from being indemnified for its own negligence to be enforceable and is different from a promise by the tenant to procure insurance covering the landlord's negligent acts, which is valid even under circumstances where an agreement to indemnify the landlord for its own negligence would not have been valid. However, the tenant breached its obligation to procure insurance covering the landlord's own acts or omissions, which did not contain the same carve-out for the landlord's negligent acts that the lease indemnity provision contained.

The lessons to be learned here are to be sure the parties understand what areas each is to insure (here the landlord was to have insured its activities in areas that were not a part of the premises, and the tenant's obligation was to insure activities within the leased premises), and in the case of the tenant, to make sure if it is to insure the landlord against the landlord's own negligent acts, it must obtain the proper additional insured endorsement to its policy.

See Endnote 16 (Latest ISO Form Additional Insured Endorsements) above for examples of what are and are not covered by various different ISO Form Additional Insured endorsements.

<sup>45</sup> **A "Misnomer"**. *Hertz Corp. v. Robineau*, 6 S.W.3d 332 1336 (Tex. App. - Austin 1999, no writ), J. Woodfin Jones, Justice:

To understand why a self-insurer's coverage is not "other insurance," it is helpful to recognize that the term "self-insurance" is a misnomer; in effect, a self-insurer does not provide insurance at all. "To say that a self-insurer will pay the same judgments and in the same amounts as an insurance company would have had to pay is one thing; while it is obvious that to assume all the obligations that exist under a Standard Automobile Liability Policy is quite another thing."

<sup>46</sup> **Self-Insurance by Large Commercial Businesses**. *Hertz Corp. v. Robineau*, 6 S.W.3d 332 (Tex. App. - Austin 1999, no writ); *H.E. Butt Grocery Co. v. National Union Fire Ins. Co.*, 150 F.3d 526 (5<sup>th</sup> Cir. 1998).

<sup>47</sup> **Self-Insurance by Public Entities**. *Green v. Alford*, 274 S.W.3d 5 (Tex. App. Hou. [14<sup>th</sup> Dist.] 2008, writ den'd) (City of Pasadena).

<sup>48</sup> **Deductibles, SIRs and Self Insurance**. 4 BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:11 *Deductibles and self-insured retentions* (2014); Windt, 3 INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 11:31 *Self-insured retention* (6<sup>th</sup> ed. 2014); Hermanson and Toren, *A Fact of Life - Retained Limits, Deductibles, and Self-Insurance* 55 No. 5 DRI FOR THE DEFENSE 64 (May, 2013); Hamilton and Murphy, *SIRs and Deductibles - Evolving Policies and Their Impact on Carrier Duties*, 78 DEFENSE COUNSEL JOURNAL 411 (Oct. 2011); CONTRACTUAL RISK TRANSFERS *Considerations for General Insurance Provisions* XIV.B.5 *Deductibles and Retentions*, and XIV.B.6 *Self-Insurance* (International Risk Management, Inc. 2020).

<sup>49</sup> **Self-Insurance is Not "Other Insurance" to Contribute as Primary Insurance**. Also, another question is sometimes raised concerning self-insurance. In a case where a loss is covered by another party's insurance, which insurance provides that it is primary coverage, and the self-insurer also is liable, is the self-insured required to share in the loss payment by the insurer? This question is sometimes stated, is self-insurance "other insurance"? If multiple policies cover a loss, the "other insurance" provisions of each the policies will dictate how the loss is allocated among the policies' proceeds. If both policies state they are primary, then the policies need to be consulted. The standard CGL policy states that its coverage is primary with respect to "other insurance" unless the other insurance is also primary, in which case the policy will pay a share of the loss. The majority rule, and the rule in Texas, is that self-insurance is not "other insurance" within the other insurance provision of a primary policy. See Holloway, Annot., *Self-Insurance against Liability as Other Insurance with Meaning of Insurance Policy*, 46 A.L.R.

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4<sup>th</sup> 707 (1986). *Allstate Ins. Co. v. Zellars*, 462 S.W.2d 550, 552 (Tex. 1970); *Hertz Corp. v. Robineau*, 6 S.W.3d 332, 335 (Tex. App. - Austin 1999, no writ).

<sup>50</sup> **Best Practice Tips - Drafting.** Charles W. Trainor, updating a 1995 Article by Sanford J. Liebshutz and Scott B. Osborne, *Subrogation-the Untold Story*.

<sup>51</sup> **Insurable Interest?.** **Question:** Under a ground lease does the landlord have an insurable interest?

<sup>52</sup> **Waiver of Subrogation as to All Insurance.** Emanuel B. Halper, SHOPPING CENTER AND STORE LEASES 12-21 (2003).

<sup>53</sup> **Example of Waiver of Subrogation as to All Insurance.** Charles W. Trainor, updating a 1995 Article by Sanford J. Liebshutz and Scott B. Osborne, *Subrogation-the Untold Story*.

<sup>54</sup> **Comprehensive General Liability Insurance vs. Commercial General Liability Insurance.** It is unclear from the case whether the policy at issue were issued prior to the change in the terminology used by ISO in its CGL policy forms or if the lease provision and the court's opinions simply used the wrong name for the CGL policy at issue. The term comprehensive general liability insurance is no longer used by CGL carriers, and the current policy forms no longer use that term.

<sup>55</sup> **Additional Insured Exclusion.** See Endnote **16** (Latest ISO Form Additional Insured Endorsements).

<sup>56</sup> **State Bar of Texas Real Estate Forms Manual – Retail Lease.** The following lease form is a Retail Lease prepared by the Real Estate Legal Forms Committee of the State Bar of Texas for use by Texas lawyers. It appears in the TEXAS REAL ESTATE FORMS MANUAL, Chapter 25 Leases along with a Basic Lease, an Office Lease, and an Industrial Lease. The author of this article has added underlining to the Retail Lease in order to highlight certain words, terms and provisions that are discussed in the accompanying footnotes.

<sup>57</sup> **“Tenant’s Rebuilding Obligation”.** See Retail Lease ¶ **D.5** – Casualty - Total or Partial Destruction and discussion below at Endnote **84** (Casualty – Total or Partial Destruction – Rebuilding Obligations). See Retail Lease ¶ **D.4** – Release of Claims / Subrogation. The TEXAS REAL ESTATE FORMS MANUAL, Chapter 25 Leases at p. 25-2 and 25-3 provides the following commentary as to *Rebuilding Obligations*:

**Rebuilding Obligations:** The restoration obligations of the parties after a casualty are tied to the description of "Tenant's Rebuilding Obligations" contained in the Basic Terms of the lease. The tenant is expected to restore those leasehold improvements described in "Tenant's Rebuilding Obligations" in addition to replacing its personal property (including inventory, furniture, trade fixtures, and equipment). Because the tenant should carry property insurance to cover its restoration obligations, a detailed description is imperative. .... The landlord's restoration obligations are defined in terms of the premises that the tenant is not required to rebuild.

For example, the tenant may be receiving the space in shell condition and be responsible for the initial construction of all leasehold improvements. The parties may decide that the tenant will restore all of the leasehold improvements inside the shell if the premises are destroyed. At the other extreme, the tenant may be receiving the premises with existing leasehold improvements after a casualty. Obviously the possibilities are infinite and depend on the economic underpinnings of the transaction as well as the relative sophistication of the parties. However, the question must be asked at the outset of the transaction so that both parties are clear about the allocation of the risk for restoration and that adequate property insurance is obtained.

See cautionary note in the Article at Scenario 3 **Part III.C.4.** (Deficiently Drafted Provisions - Covenant to Obtain Waiver of Insurer’s Right of Subrogation, But Policy Does Not Permit) as to limitations of the waiver of subrogation

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provision in the standard form **ISO CP 00 90 08 88** Commercial Property Conditions, **Form 2** in the **Appendix of Forms**.

<sup>58</sup> **“Agent”**. This definitions of **“Agent”** sets out a laundry list of other persons that are not parties to the Lease. The purpose for this laundry list is to define the Protected Persons (the person who are protected by the indemnity) as including the Agents of the Landlord and its Lienholder. To some extent it is included to narrow the scope of the Tenant’s indemnity to exclude an indemnification of Landlord to the extent the Injury is caused in whole or in part by the gross negligence or willful misconduct of Agents of the Landlord and its Lienholder. See Retail Lease ¶ **B.1.q**.

<sup>59</sup> **Indemnification for Injuries**. The defined term **“Injury”** is used in the indemnity provisions of the Retail Lease ¶ **B.1.q** and ¶ **C.1.f** Retail Lease ¶ **B.1.q** provides that “Tenant agrees to ... indemnify ... Landlord from any Injury occurring in any portion of the Premises.” Retail Lease ¶ **C.1.f** provides that “Landlord agrees to ... indemnify ... Tenant from any Injury occurring in any portion of the Common Areas.” “Injury” is defined in the Manual’s Lease forms as meaning three types of occurrences and the associated liability arising out of such occurrence: property damage, injuries to persons including their death, and “personal and advertising injury.” This last form of liability incorporates by reference the definition of such term as contained in Tenant’s liability insurance.

<sup>60</sup> **Tenant’s Repair and Restoration Obligations**. Tenant’s obligations are set out in two provisions: as to restoration obligations they are set out in the definition of “Tenant’s Rebuilding Obligations” in the Basic Information coupled with Tenant’s rebuilding covenant in ¶ **D.5** Casualty /Total or Partial Destruction. Note that there is no exclusion for damage by fire or other casualty.

<sup>61</sup> **Manual’s Approach to Reciprocal Indemnities in the Lease**. The Texas Real Estate Forms Manual’s Basic Lease, Retail Lease and Office Lease contain mutual indemnities based on the location of the occurrence, whether it is within the Premises or in the Common Areas. In Retail Lease ¶ **B.1.q** Tenant indemnifies Landlord. In Retail Lease ¶ **C.1.f** Landlord indemnifies Tenant. Each indemnity is an intermediate form indemnity, indemnifying the Protected Person for all liabilities due to the occurrence of an Injury, even if the cause is the concurrent negligence of the Protected Person. The Tenant’s indemnity is for Injuries “occurring in the Premises”. The Landlord’s indemnity is for Injuries “occurring in the Common Areas”.

Each indemnity complies with the Texas express negligence and fair notice requirements, which are imposed by the court on provisions shifting liability for negligently caused injuries from one liable person to another. Therefore, each indemnity is enforceable as a means of shifting the risk of liability to the Protecting Person for Injuries caused in whole or in part by the Protecting Person even if caused by the concurrent negligence of the Protected Person, but not if caused in part by the Protected Person’s gross negligence.

The following is a quoted portion of the commentary in chapter 25 Leases, p. 25-2 of the TEXAS REAL ESTATE FORMS MANUAL (3 ed.) § 25.1:4 *Cautions: Risk Allocation*:

**Indemnities and Waivers:** The indemnity provisions of the multitenant building or project lease forms are designed to protect the respective parties from their own ordinary negligence (but not gross negligence or willful misconduct) on a **geographic basis**; that is, the tenant indemnifies the landlord for any damage or injury occurring within the **premises**, whether or not the ordinary negligence of the landlord is a cause of the damage or injury, and the landlord indemnifies the tenant for any damage or injury occurring within the **common areas**, whether or not the ordinary negligence of the tenant is a cause of the damage or injury. The waiver of subrogation provision contained in the multitenant building or project lease form releases both parties from liability for property damage and loss of revenues up to the limits of the property insurance coverages required to be carried under the lease, notwithstanding the ordinary negligence of the party causing the property damage or loss of revenues. The indemnity and waiver provisions are designed to comply

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with the two-pronged “fair notice doctrine” under Texas case law: (1) the “express negligence rule” set forth in *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987), and (2) the “conspicuousness rule” enunciated in *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993).

<sup>62</sup> **“Occurring”**. The **“occurring”** language does not expressly address the time of the occurrence. Injuries can occur after the end of the Term of a lease due to acts or omissions occurring during the Term of a lease. The indemnity does state that the indemnity survives the end of the Term of the Lease, but this may address the survivability of the indemnity as to Injuries occurring during the Term of the Lease. The timing issue is addressed by adding after the words “occurring in any portion of the Premises” the words: **“either before or after the end of the Term”**. Note that this trigger language is not the broad form used in the standard ISO liability insurance policy in defining the scope of additional insured coverage for Injuries **“in connection with** that part of the premises leased to (the tenant).”

<sup>63</sup> **“Premises”**. **“Premises”** is defined in the Basic Terms section of the Retail Lease. The risk allocation scheme adopted in the Texas Real Estate Forms Manual for Leases is to allocate responsibility to the Tenant for all Injuries occurring in the Premises and to allocate to the Landlord responsibility for all Injuries occurring in the Common Areas, but in each geographic allocation excepting Injuries caused in whole by the Protected Person. The Retail Lease contains reciprocal indemnities with the Tenant indemnifying the Landlord for all Injuries occurring in the Premises and with the Landlord indemnifying Tenant for all Injuries occurring in the Common Areas, but in each geographic allocation excepting Injuries caused in whole by the Protected Person.

<sup>64</sup> **“Independent of Tenant’s Insurance”**. This language is added to address those cases in which the court has sought to interpret the Protecting Person’s indemnity in cases of ambiguity by examining the scope of a Protecting Person’s insurance covenant and the risks covered thereby to determine the intended breadth of the indemnity to scope and limits of the insurance.

<sup>65</sup> **The Texas Workers Compensation Act**. The Texas Workers Compensation Act provides that a subscribing employer has no liability to reimburse or hold another person harmless for a judgment or settlement resulting from injury or death of an employee “unless the employer executed, before the injury or death occurred, a written agreement with the third party to assume the liability.” Texas Workers’ Compensation Act, TEX. LABOR CODE § 417.004, repealing TEX. REV. CIV. STAT. ANN. Art. 8308-4.04, formerly Art. 8306, § 3(d).

<sup>66</sup> **Not Be Limited by Comparative Negligence Statutes or Workers Compensation Insurance**. This language notes that the indemnity is intended by the parties not to be limited by the statutory risk allocation schemes set up in the Comparative Negligence and Proportionate Responsibility Statutes and the Workers’ Compensation Act. A contractual indemnity by the employer of the injured employee is necessary to overcome the Workers Compensation Bar so as at least to pass back to the employer the employer’s percentage of responsibility which otherwise would be borne by the Protected Person absent the indemnity. The contractual indemnity should also be drafted to pass back to the employer the costs of defense of the employee’s claim.

In *Varela v. American Petrofina Co. of Texas, Inc.*, 658 S.W.2d 561 (Tex. 1983) the Texas Supreme Court held that an employer’s negligence could not be considered in a third-party negligence action bought by an employee arising out of an accidental injury covered by workers’ compensation insurance. The jury had determined that the accident was attributable as follows: plant owner’s negligence (Petrofina) – 43%, employer’s negligence (Hydrocarbon Construction) – 42%, and employee’s negligence (Varela) – 15%. The supreme court reversed the trial court’s reduction of the damage award from \$606,800 to \$243,924, or 43% of total damages. The supreme court held that the Workers Compensation Act is an exception to the Comparative Negligence Statute and disallowed contribution from the employer.

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The enforceability of a contractual indemnity passing back to the employer a third party's negligence over the "Workers Compensation Bar" has been upheld as the means of passing back to the employer the proportion of the negligently caused injury caused by the employer. *Enserch Corp. v. Parker*, 794 S.W.2d 2, 7 (Tex. 1990).

<sup>67</sup> **Retail Lease ¶ B.1.g.: Tenant's Indemnity for Injury Caused by the Concurrent Negligence of the Protected Person and the Protecting Person.** The "even if an Injury is caused in part by the ordinary negligence of Landlord" language in ¶ B.1.g. expressly addresses the issue as to whether the Tenant's (the Protecting Person's) indemnity covers an Injury caused "solely" by the negligence of the Landlord (the Protected Person) (answer: "no").

**Texas:** Absent the inclusion of an express reference to the negligence of the Protecting Party as a cause of the Injury, the indemnity provision would not have met Texas' express negligence test. The Texas Supreme Court in *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705, 708 (Tex. 1987) held that, if indemnity is sought by the Protected Person for the concurrent negligence of the Protecting Person, the indemnity has to state so expressly. The court termed this claim as one for "contractual comparative indemnity." The court held that the indemnity provision did not meet the express negligence test in this respect.

**Illinois:** The result would be different in Illinois. Because by statute in Illinois, a landlord cannot be indemnified against its own negligence, an Illinois court might have voided the entire indemnification clause because it seeks to indemnify the landlord for its own negligence or would have voided the portion of the Part III.C.6 (Deficiently Drafted Provisions - Overly Broad Indemnity May Invalidate Entire Indemnity Proviso).

<sup>68</sup> **Texas: Texas Anti-Indemnity Act Strikes Down Broad Form and Intermediate Form Indemnities in "Construction Contracts".** With some exceptions, Texas Insurance Code chapter 151 prohibits broad-form and intermediate indemnities in construction contracts and requirements in a construction contract for insurance policies or endorsements that cover broad-form or intermediate indemnities. Under Texas Insurance Code § 151.102, an indemnity in a construction contract, or in an agreement collateral to or affecting a construction contract, is void and unenforceable to the extent that it requires an indemnitor to indemnify a party, including a third party, against a claim caused by the negligence or fault, violation of a law, or breach of a contract the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier. The definition of a "construction contract" contained in § 151.102 of the Texas Insurance Code is extremely broad, and includes

Any contract, subcontract, or agreement ... made by an owner ... for the design, construction, alteration, renovation, remodeling, repair, or maintenance of ... a building, structure, appurtenance, or other improvement to or on ... real property."

The following comment is made in the TEXAS REAL ESTATE FORMS MANUAL in Chapter 17 Risk Allocation: Indemnity, Waiver, and Insurance at p. 17-3 (3d ed. 2020):

Whether the definition covers a lease that contemplates leasehold improvements or contains provisions regarding repairs, maintenance, or alterations is, at best, unclear.

<sup>69</sup> **Texas: "But Will Not Apply To." "Except Sole Negligence of the Protected Person".** The drafter of an indemnity clause cannot use the exclusion clause as a means of impliedly including within the coverage clause by implication items not excluded. In *Singleton v. Crown Central Petroleum Corp.*, 729 S.W.2d 690 (Tex. 1987), the Texas Supreme Court found that the following provision failed the express negligence standard since the provision stated what was not to be indemnified included claims resulting from the sole negligence of the premises owner rather than expressly stating that the premises owner was to be indemnified from its own negligence.

Contractor agrees to ... indemnify ... owner from and against any and all claims ... of every kind and character whatsoever, ... for or in connection with loss of life or personal injury ... directly or indirectly arising out of ... the activities of contractor ... **excepting only** claims arising out of accidents resulting from the **sole negligence** of owner. (Emphasis added by author.)

*Linden-Alimak, Inc. v. McDonald*, 745 S.W.2d 82 (Tex. App.—Ft. Worth 1988, writ denied). *Texas Utilities Electric Co. v. Babcock & Wilcox*, 893 S.W.2d 739 (Tex. App.—Texarkana 1995, no writ).

<sup>70</sup> **Revise Indemnity to Correct Conflict with Waiver of Subrogation - Need to Exclude from Indemnity Liabilities and Damages Insured by Protected Party's Property Insurance.** The breadth of the indemnity conflicts with ¶ **D.4** Release of Claims / Subrogation. The mutual indemnities in ¶¶ **B.1.q.** and **C.1.f.** should be revised to include as an additional exclusion

**(iv) DOES NOT INDEMNIFY THE PERSONS INDEMNIFIED IN THIS SECTION (THE PROTECTED PERSONS) FOR CLAIMS OR LIABILITIES RELEASED IN PARAGRAPH D.4 RELEASE OF CLAIMS / SUBROGATION.**

<sup>71</sup> **Landlord Repair and Restoration Obligations.** The Retail Lease allocates the risk of liability damage or destruction of the Property and Premises to the party to which is allocated the Rebuilding Obligation, irrespective of whether the damage or destruction arises in whole or in part from the other party's negligence, and confirms this allocation through the release of claims and waiver of subrogation provision in ¶ **D.4 Release of Claims / Subrogation.** ¶ **D.4** provides

**THE RELEASE IN THIS PARAGRAPH WILL APPLY EVEN IF THE DAMAGE OR LOSS IS CAUSED IN WHOLE OR IN PART BY THE ORDINARY NEGLIGENCE OR STRICT LIABILITY OF THE RELEASED PARTY BUT WILL NOT APPLY TO THE EXTENT THE DAMAGE OR LOSS IS CAUSED IN WHOLE OR IN PART BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE RELEASED PARTY OR ITS AGENTS.**

See Endnote <sup>78</sup> (Release of Claims) for a discussion of this provision.

<sup>72</sup> **Landlord's Intermediate Indemnity as to Injuries in the Common Areas.** See analysis of the mutual indemnity by the Tenant above. Landlord's indemnity is for all Injuries occurring in any portion of the Common Areas, even if the Injury is caused in part by the negligence of the Tenant.

<sup>73</sup> **Omission of Agents.** Note that "Agents" are not included as a Protected Person in ¶ **C.1.f.**, Landlord's indemnity of Tenant, nor in the list of parties for whose gross negligence is excluded in Landlord's indemnity, as was addressed in Tenant's indemnity of Landlord in ¶ **B.1.q.** An oversight?

<sup>74</sup> **Revise to Exclude from Indemnity Liabilities and Damage Insured by Protected Party's Property Insurance.** The breadth of the indemnity conflicts with ¶ **D.4** Release of Claims / Subrogation. The mutual indemnities in ¶¶ **B.1.q.** and **C.1.f.** should be revised to include as an additional exclusion

**(iv) DOES NOT INDEMNIFY THE PERSONS INDEMNIFIED IN THIS SECTION (THE PROTECTED PERSONS) FOR CLAIMS OR LIABILITIES RELEASED IN PARAGRAPH D.4 RELEASE OF CLAIMS / SUBROGATION.**

<sup>75</sup> **Ownership of Tenant Improvements.** The Texas Real Estate Form Manual's Retail Lease provides that tenant made alterations "will become the property of Landlord." **ISO CP 00 10 10 12** Building and Personal Property Coverage Form insures a tenant's interest in betterments and improvements under the following provision:

A. Coverage

1. Covered Property. Covered Property, as used in this Coverage Part, means ....
  - b. Your Business Personal Property consists of the following property located in or on the building or structure described in the Declarations ...:
    - (6) Your use interest as tenant in improvements and betterments. Improvements and betterments are fixtures, alterations installations or additions:
      - (a) Made a part of the building or structure you occupy but do not own; and
      - (b) You acquired or made at your expense but cannot legally remove.

<sup>76</sup> **Return of Premises Clause Needs Revision.** See this Article II.E (Common Law - Exception for Casualty Loss to Return of Premises) and Article III.B.1 (Drafting Conflicting Provisions - Waiver of Claims vs. Return of Premises). Note this clause fails to contain an express exclusion for "casualty loss" (e.g., "fire"; or "fire even if caused by Tenant's negligence"). The authors recommend adding an exclusion for "casualty loss" to the return of premises clause to clarify that Tenant is not obligated to bear the risk of loss and the cost of restoring the premises in the event of a casualty loss, even caused by Tenant's negligence.

and restore the Premises to the condition existing at the Commencement Date, normal wear and **casualty loss** excepted.

<sup>77</sup> **No Rent Abatement Except.** The Retail Lease at ¶ *D.2* provides that there is no rent abatement "*except as otherwise provided*". ¶ *D.5.c* provides in the case untenability following a casualty for the Rent to be "*adjusted as may be fair and reasonable*."

<sup>78</sup> **"Release of Claims".** ¶ *D.4* (Release of Claims/Subrogation) is both a release of claims between the parties as to property damages by "*that are insured by the Releasing Party's property insurance or that would have been insured by the required insurance if the party fails to maintain the property coverage required by this lease*" and a covenant to notify the insurance issuers of the release and to have the insurance companies endorse, if necessary, the policies so as to prevent invalidation of the policies because of the release. This provision expressly identifies negligence of the parties as being a Released Matter in compliance with the requirements of the express negligence test (see discussion in Part II.E (Common Law - Exception for Casualty Loss to Return of Premises)). The release is written in conspicuous type and meets the requirements of the fair notice test (see discussion in Part II.E (Common Law - Exception for Casualty Loss to Return of Premises)).

**Advice.** The Form's insurance provision supplements this contractual waiver of the property insurance carrier's right of subrogation only as to the Tenant's property insurance. The Form's risk management provisions provide that the Tenant's property insurance policies must contain waivers of subrogation of claims against the Landlord and the Lienholder. The Form does not, however, contain a reciprocal provision requiring that the Landlord's property insurance policies contain a waiver of subrogation claims against Tenant. See **Insurance Addendum** ¶ A.2.b as compared to ¶ B. The authors of this Article recommend that tenants seek to add a reciprocal provision to the

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landlord's insurance specifications providing that the landlord's property insurance contain a waiver of subrogation claims against tenants.

<sup>79</sup> **Waiver of Subrogation.** See Commercial Property Conditions ¶ I. Transfer of Rights of Recovery Against Others To Us in the forms set forth in **Form 2** of the Appendix of Forms. The ISO form property policy for leased premises allows the parties to waive the insurer's rights **before** a loss by a waiver of claims in the lease. The ISO form property policy also allows the landlord to waive the insurer's subrogation right even **after** a loss.

Most leases, including leases in the Texas Real Estate Forms Manual, contain a provision addressing the rights between the parties in the event that the property is damaged by the negligence of the other party. Leases may provide that the party whose property is damaged waives claims against the other negligent party and that the damaged party will look to the property insurance for recovery. Further leases may provide that the right of subrogation of the insurer is waived or that the party obtaining the insurance will also obtain an endorsement to the property policy whereby the insurer waives its rights of subrogation to recovery its insurance proceeds against the negligent party.

**Waiver of Subrogation Endorsement.** Since there is no recognized standard property policy form, it is prudent to examine the property policy in connection with drafting the lease and to condition the lease, if necessary, on obtaining a subrogation waiver from each party's insurer.

**Waiver of Subrogation from Subtenant's Insurers.** A landlord may appropriately require subtenants to secure a waiver of subrogation from their insurers. In order to require such a waiver, the lease either needs to require it or, if the landlord has a right to consent to any sublease, the landlord can include that requirement in its form of Landlord's Consent.

<sup>80</sup> **"Each Other and their Respective Agents".** The released parties are "each other ... and their respective Agents". The term "**Agent**" is not defined as including "officers, directors, shareholders, partners, members, and managers". Consideration should be given to expanding the released persons to expressly include these persons as released persons. Additionally, the waiver does not extend to the tenant's subtenants and that extension should be considered.

LANDLORD AND TENANT RELEASE EACH OTHER AND LIENHOLDER, AND THEIR RESPECTIVE AGENTS, <b>OFFICERS, DIRECTORS, SHAREHOLDERS, PARTNERS, MEMBERS, AND MANAGERS</b> [Add: <b>AND TENANT'S SUBTENANTS</b> ] [ADD: <b>JOINT VENTURER'S OF TENANT</b> ].
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Texas courts strictly construe releases and will not extend them to unnamed persons. In *McMillen v. Klingensmith*, 467 S.W.2d 193 (Tex. 1971), the court held that a release discharges only those tortfeasors that it specifically names or otherwise specifically indemnifies. The Texas Supreme Court in *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414 (Tex. 1984) approved the decisions in *McMillen*, and in *Lloyd v. Ray*, 606 S.W.2d 545, 547 (Tex. Civ. App.—San Antonio 1980, writ ref'd n.r.e.) and *Duke v. Brookshire Grocery Co.*, 568 S.W.2d 470, 472 (Tex. Civ. App.—Texarkana 1978, no writ) held that the mere naming of a general class of tortfeasors in a release does not discharge the liability of each member of that class. A tortfeasor can claim the protection of a release only if the release refers to him by name or with such descriptive particularity that his identity or his connection with the tortious event is not in doubt. Also see *Angus Chemical Co. v. IMC Fertilizer, Inc.*, 939 S.W.2d 138 (Tex. 1997) where the court held that the release by an injured party of a tortfeasor does not release the tortfeasor's insurer; *Illinois Nat. Ins. Co. v. Perez*, 794 S.W.2d 373 (Tex. App.—Corpus Christi 1990, writ den'd).

In *Blohm v. Johnson*, 523 N.W.2d 14 (Minn. Ct. App. 1994), a subrogation claim that was prohibited against negligent tenant due to absence of a lease requirement to carry fire insurance was not made viable by fact that the fire resulted from the tenant's joint enterprise with the third party joint venturer of tenant who was also found negligent.

<sup>81</sup> **Release of Claims and Waiver of Subrogation is Limited to Property Damages.** Note the release is only as to claims or liabilities for damage that are insured by the releasing party's property insurance (or that would have been insured by the required insurance if the party fails to maintain the property insurance required by the lease).

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The parties are not releasing each other for the (b) and (c) portion of “Injuries” as defined in the Definitions (“(b) harm to or death of a person” and “(c) “personal and advertising injury” as defined in the form of liability insurance Tenant is required to carry”). Also, there is no companion contractual waiver of recovery with respect to the CGL insurance carrier’s right of subrogation against the party causing the non-property damage Injury.

**Question:** Should there be a release of claims and waiver of subrogation to the extent of liability insurance a party is required to carry under the lease?

**82 Notice to Insurance Companies of Release - Questions.**

**Question 1:** How many landlords and/or tenants will actually give notice of their before loss contractual release of claims and waiver of subrogation?

**Question 2:** Should this requirement be qualified by the phrase “**if necessary**” since many policies, particularly if they are written on the ISO forms, do not require notice to the insurer of any such release.

**Question 3:** Should the notice go to the issuers of the parties’ CGL policies as well?

**83 Exclusion from Waiver of Claims of Gross Negligence.** The waiver of claims language excludes from the waiver claims arising out of the gross negligence of the Released Party. With regard to property insurance, gross negligence or intentional misconduct of a party other than the named insured may not be a defense to coverage. In the case of the Landlord’s property insurance, there is no negligence standard for recovery so why should the Tenant’s gross negligence be carved out of the release? Why would the Landlord, want its insurance company to go after a Tenant who might not have the funds to repay the insurance company for the loss of Landlord’s building (suppose it is a total loss or a pretty significant loss), especially if the Tenant is a mom and pop or small business, thereby risking putting the Tenant out of business so that if the building is rebuilt Landlord will no longer have a Tenant? Even if it is not a total loss, the contractual liability coverage under the Tenant’s CGL policy would not be sufficient to cover much of a loss (if it even covers it, there is a carveout for loss by fire from the contractual liability coverage in a CGL policy). The parties can provide that Landlord has the right to go after the Tenant for the deductible even if the Tenant was just negligent or more culpable, but that would not involve the insurer, since it did not cover the deductible in the first place.

**Question:** Should the lease provide for an exception to the exclusion to the extent these risks are covered by the property policy of the Releasing Party?

**84 Casualty - Total or Partial Destruction - Rebuilding Obligations.** The typical lease will assign responsibility for the maintenance of property insurance covering the building and other improvements to one party or the other. Under a long-term lease, especially when a single tenant occupies the entire premises, the lease allocates this obligation to the tenant. In multitenant situations, like a retail Shopping Center, the lease typically specifies that the landlord is to maintain the property insurance or is silent. In cases where the landlord is to maintain the insurance, the lease may state that the insurance is maintained for the benefit of the landlord, or is for the benefit of landlord and tenant, or may be silent on the subject of insurance and/or for whose benefit the insurance is to be maintained.

**Manual’s Commentary.** The following is a quoted portion of the commentary in Chapter 25 Leases, p. 25-2 of the TEXAS REAL ESTATE FORMS MANUAL (3rd ed. 1/2020) §25.1:4 Cautions: Risk Allocation:

**Rebuilding Obligations:** The restoration obligations of the parties after a casualty are tied to the description of “Tenant’s Rebuilding Obligations” contained in the Basic Terms of the lease. The tenant is expected to restore those leasehold improvements described in “Tenant’s Rebuilding Obligations” in addition to replacing its personal property (including inventory, furniture, trade fixtures, and equipment). Because the tenant should carry property insurance to cover its restoration obligations, a detailed description is imperative. ... The landlord’s restoration obligations are defined in terms of the portions of the premises that the tenant is not required to rebuild.

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For example, the tenant may be receiving the space in shell condition and be responsible for the initial construction of all leasehold improvements. The parties may decide that the tenant will restore all of the leasehold improvements inside the shell if the premises are destroyed. At the other extreme, the tenant may be receiving the premises with existing leasehold improvements, and the parties may decide that the landlord should restore all leasehold improvements after a casualty. Obviously, the possibilities are infinite and depend on the economic underpinnings of the transaction as well as the relative sophistication of the parties. However, the question must be asked at the outset of the transaction so that both parties are clear about the allocation of the risk for restoration and that adequate property insurance is obtained.

The Retail Lease uses but does not define the term "casualty". See the **Practice Point** in Endnote 7 (Casualty Loss) recommending the inclusion of a definition.

**85 “Fair and Reasonable” Rent Abatement - Questions.**

**Question 1:** Does rent abatement extend to cover the period that the Tenant is performing the Tenant’s Rebuilding Obligation?

**Question 2:** Should the Tenant’s Rebuilding Obligations or the Landlord’s rebuilding obligation include the improvements to the Tenant’s space to restore it to a condition it can open for business (carpet, interior partitioning, lighting, HVAC)?

**Insurance Addendum to Lease**

**86 Texas Real Estate Form Manual’s Lease - Insurance Addendum.** The Texas Real Estate Form Manual’s Lease forms rely on an **Insurance Addendum** to detail the insurance coverages required to be maintained by the parties. The Manual’s Insurance Addendum to Lease is an attachment to the lease form. It can be given to the parties’ insurance consultants and insurers as a ready checklist of required coverages. The Insurance Addendum specifies the types of insurance to be maintained by landlord and tenant, but utilizes different means to identify the geographic coverages for landlord and tenant for liability insurance coverage and property insurance coverage.

The Insurance Addendum identifies the portion of the Shopping Center/Building to be covered by Tenant’s property insurance as “*all items included in the definition of Tenant’s Rebuilding Obligations....*” Landlord’s property insurance is to cover “*the Building exclusive of ... the rebuilding requirements of all lessees.*”

The Lease and its Insurance Addendum do not similarly state the geographic area to be covered by the Landlord and Tenant’s liability insurance, but rely on the geographic coverage terms and definitions of the party’s liability policy.

Insurance Addendum ¶ A.1 contains a “check the box” choice between a  commercial general liability policy (occurrence basis) or  business owner’s policy and a “check the box” choice of the following designations and various lines of coverage added by endorsement to the standard coverage of the selected liability form:  designated location general aggregate limit,  workers’ compensation,  employer’s liability,  business automobile liability,  excess liability or  umbrella liability (occurrence basis).

Insurance Addendum ¶ A.2.a. provides that the liability policy is to be endorsed to name the Landlord and its Lienholder as “additional insureds;” Insurance Addendum ¶ A.2.b. provides that the contractual liability coverage under Coverage A be sufficient to respond to a broad-form indemnity; Insurance Addendum ¶ A.2.b. provides that the property insurance must contain waivers of subrogation of claims against Landlord and Lienholder; and at Insurance Addendum ¶ A.2.c. that Tenant is to deliver to Landlord copies of the certificate of insurance and copies of any additional insured and waiver of subrogation endorsements.

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Insurance Addendum ¶ A.3. contains the further requirement that Landlord’s approval is required with respect to the following: the forms of Tenant’s insurance policies, endorsements and certificates; the amounts of any deductibles; and the creditworthiness and ratings of the insurance companies issuing Tenant’s Insurance.

**87 Policy Forms.** The Insurance Addendum does not cover in detail the coverages required to be contained in the Tenant’s and the Landlord’s liability policies other than to provide that each is an occurrence basis policy and is to have the minimum coverage levels specified. The Insurance Addendum relies on Landlord’s approval authority in Insurance Addendum to Lease ¶ A.3. as opposed to specifying in the Insurance Addendum minimum standards to be met in the policy to be furnished by Tenant.

**88 Additional Insureds.**

**Practice Point:** Consideration should be given to listing in the insurance specifications specific companies that are to be scheduled as additional insureds on the Tenant’s CGL policy.

**Practice Point:** Also, all parties referenced or identified in the Tenant’s indemnity as a Protected Person should also be listed as an additional insured on Tenant’s CGL policy. Nobody (except the insurer) wins when a party is a Protected Person but is not scheduled as an additional insured. If it is intended that persons in addition to the named Landlord are to be listed as additional insureds, then consideration should be given to specifically naming or listing the most important of these persons in the additional insured endorsement form. *E.g.*, see the Schedule box in **ISO CG 20 10 12 19 Additional Insured – Owners, Lessees or Contractors – Scheduled Persons** and in **ISO CG 20 11 12 19 Additional Insured - Managers or Lessors of Premises**. Standard additional insured endorsement forms do not extend coverage to the officers, directors and partners of the additional insured.

**No Geographic Limitation of Tenant’s Additional Insured Endorsement Coverage Specified.**

**Insurance Addendum ¶ 2.a** does not specify or limit geographically the area of the Building to which Landlord’s protection as additional insured is to extend. This is different from how the parties allocated liabilities by the indemnities. In the Lease’s indemnity provisions the parties have carved up responsibility for liability based on geographic areas (Tenant is responsible for Injuries occurring in the Premises; Landlord is responsible for Injuries occurring in the Common Areas). This anomaly gives rise to a variance in coverage between a party’s indemnity and its required insurance coverage. For example, if an Injury occurs in the Common Areas, Landlord is to indemnify Tenant. However, Landlord has coverage for such liability to the extent it is a protected for that liability pursuant to the additional insured endorsement on Tenant’s liability policy.

**ISO CG 20 11 12 19 Additional Insured - Managers or Lessors of Premises.** For example, an **ISO CG 20 11 12 19** can be used to designate the Landlord as an additional insured on Tenant’s CGL policy. The standard form utilizes the term “*premises*” to define the geographic area giving rise to coverage. This endorsement provides a box for the description of the “Premises.” Care must be exercised in completing this box.

**Practice Point:** This endorsement has a major potential coverage issue. It extends coverage to the additional insured landlord for liability for bodily injury and property damage “caused in whole or in part, by you (the tenant) or those acting on your behalf in connection with the ownership, maintenance or use of that part of the premises leased” to the Tenant. A coverage issue may occur if the bodily injury or property damage occurs outside of the “premises” as such term is defined in the lease (for example, in the common areas maintained by the landlord or in the alley behind the project). The most common factually litigated scenario regarding these endorsements involves injuries occurring “outside” the “part” of the premises “shown in the Schedule” leased to the tenant. This issue can also take on the nuance of whether coverage is affected if the Schedule designates more or less than the “part of the premises” leased to the named insured. Some courts have found in cases decided based on older versions of this endorsement, which covered bodily injury or property damage “arising out of” ownership, maintenance or use of the premises, that the reference to “premises” is not a geographic limitation of the additional insured’s coverage. Such courts have construed the endorsement’s use of “arising out of” the premises as meaning that the injury or damage

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does not have to actually occur in the premises. However, some courts have placed a literal meaning on the “premises” and have required the injury to occur in the premises leased to a tenant.

Cases Finding No Coverage. For example, in *General Accident, Fire and Life Assurance Corp. v. Travelers Ins. Co.*, 556 N.Y.2d 76 (1990), the court held that the additional insured endorsement did not cover a claim brought by the named insured’s injured employee when the injury occurred outside the leased “premises.” The court denied coverage even though tenant named insured’s CGL policy was endorsed to name its landlord as an additional insured and designated the landlord’s entire property as the “premises.” The court reviewed the lease and found that it defined the term “premises” as a specific area and the “premises” was not where the injury occurred. New York follows a rule that these type endorsement designate the covered location where the injury must occur, and do not provide coverage when the injury occurs outside of the designated area even though the “occurrence” might be viewed as having “sprung” from the use of the landlord’s facility. See *Greater N. Y. Mut. Ins. Co. v. Mut. Marine Office, Inc.*, 3 A.D.3d 44, 769 N.Y.S.2d 234, 237 (2003), N. Y. App. Div. Lexis 13316 (2003) a case involving an injury that occurred to a HVAC repairman who was injured while walking on the roof of a landlord’s multi-tenant retail center to get to a HVAC unit that the tenant was obligated to maintain pursuant to lease of a retail space in the center. The additional insured endorsement form was the above ISO CG 20 11 Additional Insured – Managers and Lessors of Premises. The court found that the additional insured endorsement did not insure the landlord for the injury as the injury neither occurred in the retail space leased to tenant or on the roof directly above the space. *Northbrook Ins. Co. v. American Stats Ins. Co.*, 495 N.W.2d 450 (Minn. 1993)-additional insured endorsement held not to cover injuries occurring in alley behind named insured’s bakery in a shopping center (in this case an employee of the bakery was injured when he slipped on ice while loading a truck parked in the alley behind the shopping center) and the additional insured endorsement described the “premises” as the 3,200 square feet of space occupied by the named insured tenant. The court stated:

The additional insured endorsement under which (the landlord) was added as an insured specified it provided coverage, only with respect to liability arising out of the ownership, maintenance or use of the insured premises, i.e., the bakery. By its terms, the endorsement provides coverage for (the landlord’s) negligence *in the bakery*. Coverage is not provided for the rest of the shopping center.

The court also reasoned that since the lease provided for the landlord to maintain the alley the parties did not intend to transfer to the tenant’s insurer the risk of liabilities occurring in the alley. A similar conclusion was reached in *Minges Creek v. Royal Ins. Co. of Am.*, 442 F.3d 953 (6th Cir. 2006). This case arose out of injury to a customer of a card shop who slipped in the icy parking lot of the mall in which the shop was located. The customer sued both the card shop and the mall. The lease provided that the shop was required to maintain liability insurance “with respect to the leased premises and the business operated by the tenant” and to “name landlord (i.e., the mall owner), any other parties in interest designated by landlord, and tenant as insured.” The additional insured endorsement to Tenant’s CGL policy provided coverage to the additional insured landlord “with respect to liability arising out of premises owned or used by you (the tenant).” The court held that the landlord was not insured against the liability by tenant’s additional insured endorsement. The court viewed the lease and the additional insurance endorsement as “inextricably intertwined” and stated that they “should be interpreted in context with each other.” The court concluded that the card shop was required by its lease to provide insured status for the mall only with respect to the “leased premises”—the limited square footage set out in the lease, 6,796 square feet of interior space as shown in the mall’s site plan attached to the lease. The court found that although the parking lot was provided for the “use” of the card shop and other tenants, it was not part of the “premises” used by the card shop. The court found that the context of the lease agreement “requires that the definition of premises in the policy be coextensive with the card shop’s obligation to name (the mall owner) as an additional insured.” Also see *USF&G v. Drazic*, 877 S.W.2d 140 (Mo. 1994)-additional insured not covered for injuries to named insured tenant’s employee who slipped and was injured on an icy parking lot. See also cases construing the scope of indemnities as to injuries arising out of the use of the “premises” as not extending to injuries not occurring in the premises (but note courts follow a strict construction rule limiting private parties contracts not employed in construing insurance contracts): *Rensselaer Polytechnic Inst. v. Zurich Am. Ins. Co.*, 176 A.D.2d 1156, 1157, 575 N.Y.S.2d 598 (N.Y. 3rd Dept. 1991). The court was not persuaded that a duty to indemnify existed by the argument that, although the accident did not occur

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within the leased premises, it did arise out of use of the leased premises; *Commerce & Indus. Ins. Co. v. Admon Realty, Inc.*, 168 A.D.2d 321, 323, 562 N.Y.S.2d 655 (1st Dept. 1990)—finding no duty to indemnify where the cause of the damage occurred outside the leased premises.

<sup>89</sup> **“Broad Form” Indemnity Insurance?** Tenant’s indemnity in Retail Lease ¶ *B.1.q.* is an intermediate form indemnity covering all Injuries occurring in the **Premises** “*even if caused in part by the ordinary negligence of Landlord.*” This is an intermediate form indemnity, indemnifying the Landlord if its negligence contributed to the Injury but not indemnifying the Landlord if the Landlord is solely the cause of the Injury.

<sup>90</sup> **Landlord’s Approval.** This provision does not identify the deadline for seeking Landlord’s approval. If approval is deferred past the execution date of the lease, the parties place themselves in the position of arguing over the forms at a time when construction may have commenced on tenant improvements.

<sup>91</sup> **Tenant Not Afforded Reciprocal Policy Review Authority.** There is no provision in the Insurance Addendum providing Tenant with the authority to review and approve the form of Landlord’s policies or specifying minimum standards to be addressed in the policies to be furnished by Landlord.

<sup>92</sup> **Tenant Not Designated as an Additional Insured.** The Insurance Addendum to Lease does not require that the Tenant be listed as an additional insured on the CGL policy obtained by the Landlord for the Project as to Injuries occurring in the Common Areas. Tenant should consider requiring that it be listed as an additional insured on the Project’s CGL policy as to Tenant’s liability for Injuries occurring in the Common Areas. Adding Tenant as an additional insured on the Landlord’s CGL policy is in line with the indemnities contained in the Lease. Additionally, adding Tenant as an additional insured is in line with the Tenant’s expectations that it is insured by the “Building’s” insurance for which it is paying through its Pro Rata Share of Operating Expenses for injuries occurring in the Common Areas and in the Parking Garage.

See **ISO CG 20 26 12 19** Additional Insured – Designated Person or Organization: a form of additional insured endorsement to Landlord’s CGL policy. The ISO endorsement form can be tailored to limit Tenant’s protection as an additional insured to “Injuries” occurring in the Common Areas. The standard ISO form issued does not make that distinction.

<sup>93</sup> **Post-Loss Waiver of Claims.** Note this ISO form permits pre-loss waivers by either Landlord or Tenant, but does not permit post-loss waivers by tenants.