

Selected Insurance Issues in Commercial Real Estate Transactions - Understanding the Nuances -

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What is Insurance?

- Insurance is the transfer of risk via contract or agreement.
- The product of insurance depends upon your appetite for risk
 - Risk Avoidance
 - Risk Transfer
 - Guaranteed Cost
 - Large Deductible
 - Risk Retention
 - Self Insured Retention



Transferring Risk To Another Party

- Require parties to obtain (at a minimum) property and liability insurance coverage
- Creating an obligation through an indemnification provision in a contract which falls within the definition of "insured contract"
- Adding Entity/ Person as an "Additional Insured"
(be careful - scopes vary based on endorsement)



Understanding Insurance Types of Insurance Coverage Found in Leases

1st Party Insurance Coverage

- Property & Business Income
- Builders Risk Insurance
- Crime / Comprehensive Crime
- Professional Liability & Cyber Liability

3rd Party Insurance Coverage

- General & Product Liability
- Commercial Auto
- Umbrella / Excess Liability



The ART of Allocating Risk within Commercial Real Estate Agreements



How Should Agreements Address Insurance?

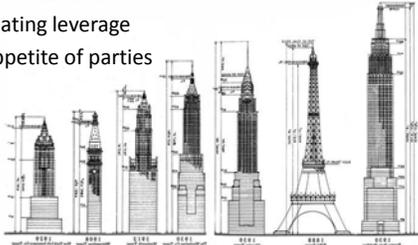
A well written agreement should clearly set forth which party bears what risk.

After the risk and the bearer of risk is established, you should determine:

1. What type of insurance policy responds and ensure the risk is not excluded by insurance
2. Determine the amount of the risk and make sure you have sufficient limits
3. Whose insurance policy should respond?

Factors Affecting Risk Allocation

- Nature and size of transaction
- Type of property
- Market conditions
- Negotiating leverage
- Risk appetite of parties



Insurance Coverage Demystified



Construction of a Policy

- Declarations Page
- Insuring Agreement
- Definitions
- Conditions
- Exclusions
- Endorsements



First Party Insurance

- First Party Policies
- All Risk vs Named Peril
- RC vs ACV
- Loss Payee
- Waiver of Subrogation
- Tenant Improvements
- Ordinance and Law
- Loss of Rents



Examples of First Party Coverages

- Property
- Cyber Property
- Auto Physical Damage
- Builders Risk Liability
- Installation Floater
- Inland Marine
 - Contractor's Equipment
 - Transit/Motor Truck Cargo
- Crime

All Risk / Special Cause of Loss Property Insurance

SUMMARY OF KEY ALL RISKS EXCLUSIONS AND LIMITATIONS

- Nuclear hazard
- War and military action
- Governmental seizure or destruction of property
- Building ordinance enforcement
- Utility service interruption
- Earth movement
- Water (flood, mudslide, seepage, and sewer backup)
- Delay, loss of use, and loss of market
- Smoke, vapor, or gas from agricultural or industrial operations
- Wear and tear, rust, corrosion, fungus, decay, deterioration, hidden or latent defect, smog, settling, cracking, shrinking, or expansion; nesting, infestation, or release of secretions by insects, birds, rodents, or animals
- Dampness, dryness, changes or extremes of temperature, and ransing or scratching, all with respect to personal property only
- Damage to electrical or electronic devices by artificially generated electrical energy
- Mechanical breakdown
- Boiler explosion
- Loss to steam and hot water equipment from any condition within the equipment
- Seepage or leakage of water, or the presence of moisture or humidity, over a period of 14 or more days
- Rain, snow, ice, or sleet damage to personal property in the open
- Weight of snow, ice, or sleet on gutters and downspouts
- Damage to building interiors by rain, snow, sleet, ice, sand, or dust unless the roof or walls are first damaged—except damage by thawing of snow, ice, or sleet.
- Leakage from equipment caused by freezing, unless certain procedures have been taken
- Collapse, except when resulting from the specified causes of loss, hidden decay, insect, or vermin damage, weight of people or personal property or rain that collects on a roof, and faulty workmanship or materials if loss occurs during construction or renovation
- Release of pollutants except when resulting from specified causes of loss
- Dishonest or criminal acts by the insured or the insured's employees (including temporary and leased employees), officers, managers, directors, trustees, or authorized representatives, or theft by anyone else to whom the insured entrusts the property
- Voluntary parting with property and unauthorized transfer of property
- Missing property when the only evidence of loss is inventory shortage
- Theft of building materials and supplies not yet attached to buildings
- Loss from fungus, wet or dry rot, and bacteria (unless resulting from fire or lightning), except as provided in the \$15,000 fungus additional coverage provision
- Loss from causes other than fire, explosion, etc., to valuable papers and records, animals, builder's machinery, tools, and equipment off premises; breakage of fragile articles
- Theft loss sublimits apply to furs, jewelry, patterns, dies, and molds; and stamps, tickets, and letters of credit

Basic and Broad Named Perils

BASIC AND BROAD NAMED PERILS

Causes of Loss Covered by Both Basic and Broad Causes of Loss Form

Fire
Lightning
Explosion
Windstorm or hail
Smoke
Aircraft or vehicles
Vandalism
Riot or civil commotion
Sprinkler leakage
Sinkhole collapse
Volcanic action
Limited coverage for fungus, wet rot, dry rot, and bacteria

Additional Causes of Loss Covered Only by Broad Causes of Loss Form

Falling objects
Weight of snow, ice, or sleet
Water damage (from certain causes)
Collapse (from certain causes)

Replacement Cost vs. Actual Cash Value

Replacement Cost Insurance



Actual Cash Value



Replacement Cost Insurance

- Require "replacement cost" or "full replacement cost"
- If not elected, policy will only pay Actual Cash Value
- Subject to specifications of policy, replacement cost insurance will provide proceeds sufficient to replace a used building with a new one
- Policy pays cost to repair or replace at the time of loss (not cost at time of original construction – but consider Ordinance and Law coverage issue)
- Replacement cost insurance must be affirmatively purchased as optional coverage



Actual Cash Value

- If replacement cost insurance is not elected, the policy will only pay "actual cash value" – property in its then current condition (taking into account depreciation)
- May result in insufficient proceeds to fully rebuild or restore
- Proceeds will also be limited to actual cash value if a building is not restored even if replacement cost insurance is obtained



Loss Payee



Loss Payee – First Party Policies

- Usually, a loss payable clause simply states that loss to covered property in which the designated loss payee has an interest will be adjusted with the insured and payable jointly to the insured and the loss payee.
- In most cases, a loss payable clause does not give the loss payee any other rights or responsibilities, although some provide for cancellation notice
- The loss payee has no more right to recover under the policy than does the insured (unlike the independent right of recovery afforded a mortgage holder by the standard mortgage clause - - consider "Lender Loss Payee" language).
- In the absence of a provision that the insurance policy shall not be invalidated by any act or neglect of the insured - - a "loss payee" is not itself an insured under the policy; it is merely the designated person to whom the loss is to be paid. It is established that such a loss payee may only recover if the insured could have recovered.

POLICY NUMBER: BUSINESS NUMBER: 8P 14 01 14

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

LOSS PAYABLE PROVISIONS

This endorsement modifies insurance provided under the following:

BUSINESSOWNERS COVERAGE FORM

Provision Number	Issuing Form	Provision Applicable To (Policy, Schedule, A, B or C)
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Waiver of Subrogation

- A special type of endorsement on a property-casualty insurance policy
- Prohibits insurer from attempting to seek restitution from a third party who causes or contributes to a loss to the insured
- Coverage is provided through special endorsements to the insured's policies
- Insured must ensure that permitted to do so by terms of policy (or insurer may deny coverage to insured)
- Standard endorsement are available to property policies that permit waiver of subrogation
- Discuss relationship with "waiver of claims" – how attorneys and insurance companies view concept

1. 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.

This will not restrict your insurance.

Who Should Insure Tenant Improvements?

- Many factors involved:
 - Who has the insurable interest?
 - Level of improvements – should other tenants "subsidize" landlord's insurance of upscale or high-end improvements for other tenants?
 - Provisions of lease and landlord's loan documents – requirement to insure for "replacement cost"
- May require a tenant to pay twice – part of Op Ex and part by maintaining own policy
- Who is required to restore tenant improvements in event of casualty?
- Administrative burden for landlord to monitor tenant's insurance of its improvements and betterments – if landlord maintains insurance, it should restore upon casualty



Ordinance and Law Coverage

- Applicable in instances where replacement cost insurance is insufficient to rebuild if original building was built prior to changes in governmental regulations enacted since original construction of building
- ISO forms of commercial property insurance do not automatically cover excess costs of complying with new or changed laws in effect at time of rebuilding
- ISO offers an endorsement to cover the deficiency between replacement cost of building and increased costs to comply with minimum standards of then current laws, codes and ordinances



Rental Value Insurance

- "Rental Interruption Insurance", "Rent Loss Insurance", "Rental Income Insurance" and "Rent Insurance" **no longer exist** by those names
- The proper, current terminology is "**rental value**" insurance
- Can be included in a property insurance policy as part of "business income" coverage
- Must be affirmatively elected as part of a business income policy
- Who should maintain rental value insurance?



Rent Value Insurance

Rental value coverage pays for the insured's loss of rental income incurred because of damage from a covered cause of loss to the rented premises.

Coverage is also provided for the rental value of the portion of the property that is normally occupied by the insured and for charges that the insured is legally obligated to pay that would normally be paid by the tenant (such as gas or electric utility service).



Third Party Insurance

- **Types of Coverages**
- **Terminology**
- **Additional Insured**
- **Waiver of Subrogation**
- **Primary & Non Contributory**
- **Coverage Triggers**
- **Contractual Liability**



Examples of Third Party Coverage

- General Liability
- Automobile
- Workers Compensation
- Umbrella Liability
- Pollution Liability
- Cyber/ Privacy Liability
- Professional Liability

Liability – Terminology

- Comprehensive General Liability is an antiquated term. Commercial General Liability is the current terminology used in the industry since 1996
- Combined Single Limit vs Per Occurrence & Aggregate
- Additional Insured vs Named Insured
- Insured vs Insured Exclusions
- Liquor Liability vs Host Liquor Liability Insurance
- Notice of Cancellation 30/60/90 Days... 10 Days for Non Payment of Premiums
- Expected or Intended Injury Exclusions
- Personal Injury and Bodily Injury



Additional Insured

- An "additional insured" is a person or entity added to a business policy for purposes of coverage
- Most often applies where the original named insured needs to provide insurance coverage to additional parties so that they enjoy protection from a new risk that arises out of the original named insured's conduct or operations
- May be automatically offered "if required by written contract or agreement" so long as the agreement is executed prior to loss
- Over 30 different additional insured endorsements, each providing varying levels of protection
- This is an endorsement to a **Commercial General Liability policy** – be aware of limitations on insurance company's obligation to provide coverage to an additional insured
- This is to be distinguished from an "additional named insured"

COMMERCIAL GENERAL LIABILITY
CG 20 10 18 04

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.
ADDITIONAL INSURED – OWNERS, LESSEES OR CONTRACTORS – SCHEDULED PERSON OR ORGANIZATION

This endorsement modifies insurance provided under the following COMMERCIAL GENERAL LIABILITY COVERAGE FORM.

SCHEDULE

<small>Name of Additional Insured (Person or Organization)</small>	<small>Location of Other Operations</small>

A. Schedule B - Who is an insured is amended to include the additional insureds listed in the Schedule B table and to include the location of other operations listed in the Schedule B table. The additional insureds listed in the Schedule B table are insured under the policy as if they were named insureds. The policy does not apply to "third party" or "other operations" of the additional insureds listed in the Schedule B table. The policy does not apply to "other operations" of the additional insureds listed in the Schedule B table. The policy does not apply to "other operations" of the additional insureds listed in the Schedule B table. The policy does not apply to "other operations" of the additional insureds listed in the Schedule B table.

B. This endorsement is the property of the insurer. It does not constitute an offer of insurance. The insured should read the policy and this endorsement carefully. The insured should read the policy and this endorsement carefully. The insured should read the policy and this endorsement carefully. The insured should read the policy and this endorsement carefully.

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Waiver of Subrogation

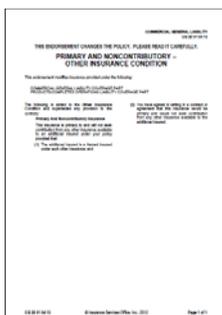
- A special type of endorsement on a property-casualty insurance policy
- Prohibits insurer from attempting to seek restitution from a third party who causes or contributes to a loss to the insured
- Coverage is provided through special endorsements to the insured's policies
- Insured must ensure that permitted to do so by terms of policy (or insurer may deny coverage to insured)
- Standard endorsement are available to property policies that permit waiver of subrogation
- Discuss relationship with "waiver of claims" – how attorneys and insurance companies view concept



Primary & Non-Contributory

If more than one policy is available to respond to a loss, the policy which has been endorsed to provide additional insured protection will be primary over any other valid insurance.

Insurance policies have automatic provisions which require that if more than one policy is triggered for a particular event, both policies will share in the loss (or contribute). This can only be overcome through the addition of contractual wording and a policy endorsement to recognize this order of protection.



Insuring Agreements "Occurrence" vs. "Claims Made"

- Occurrence Coverage - the policy in effect when the occurrence takes place will respond
- Claims Made Coverage
 - Policy in place when the claim is actually made and reported to the insurance company will respond
 - Retroactive Date & "prior acts coverage"
 - "Tail" coverage
 - Must report claims within policy period or extended reporting period

Contractual Liability Coverage

- Applies when party to contract agrees to assume liabilities of another party to the contract – typically in indemnification provision
- CGL policies typically exclude claims against insured under indemnification provision – “Contractual Liability” Exclusion
- CGL policy will, however, cover claims against insured assuming liability under “**insured contract**” – 6 types of insured contracts
- Covers claims in tort, not breach of contract

What coverage is provided and what is the most current terminology?

- Common Insurance Services Organization “ISO” Forms:
- “All Risk” Property Coverage Form
 - Form provided by most global insurers and provides coverage for “All Risks” unless otherwise excluded
 - Do not be misled by the name of the policy!
 - NO policy affords coverage for “all risks”
- Take caution to understand exceptions and exclusions
- ~~Comprehensive~~ General Liability insurance has not been available in 30 years – the correct term is “Commercial General Liability Insurance” or “CGL”
- The phrase “combined single limit” is no longer in use in CGL policies

Certificates of Insurance

WHAT YOU NEED TO KNOW?



Certificates of Insurance

- Provides evidence of insurance coverage for information purposes only
- Conveys policy information and limits of insurance at time of issuance
- Is not an insurance policy and does not provide coverage
- The terms in the actual insurance policy will prevail

Certificates of Insurance (cont.)

Notice of Cancellation:

- Many certificate holders will want to receive notification from the insurance company if the policies are cancelled, not renewed or materially changed
- Very few insurance companies will provide such notice
- The wording on standard certificates recently changed

- Old wording

- New wording

CANCELLATION

WHENEVER ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF THE ASSURED WILL BE ADVISED BY MAIL, WITH WRITTEN NOTICE TO THE CERTIFICATE HOLDER AS SOON AS THE LAST PREMIUM DUE TO BE PAID HAS BEEN PAID OR VALIDATION OF LIABILITY OF ANY ONE OF THE INSURED, ITS AGENTS OR REPRESENTATIVES.

CANCELLATION

WHENEVER ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.

Certificates of Insurance (cont.)

- Obtain and read the Declaration page as definitive evidence of proper insurance coverage
- Obtain and read copies of endorsements
- Continuously monitor policies and endorsements to ensure that agreed-upon insurance is in place, premiums are paid, policies remain valid and enforceable and no changes

PARTING THOUGHTS

- Stay current and use proper terminology
- Understand your client's business and possible risk protection needs
- Ensure that insurance provisions are consistent and "fit" together with other provisions of the contract
- Address insurance issues as early in the transaction as possible



ALWAYS CONSULT A PROFESSIONAL INSURANCE CONSULTANT!!!



Real Life Examples

UNDERSTAND YOUR CLIENT'S BUSINESS AND EXPLORE POSSIBLE SPECIALIZED COVERAGE
