CGL contractual lease coverage

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Simplified CGL
When the new simplified commercial general liability (CGL) policy was introduced in 1986, it was expected to help solve some coverage problems. While the jury is still out as to whether all the coverage problems have been solved, there is one issue that can be settled. The so-called simplified CGL policy is anything but simple! The CGL policy is one of the most complex policies that an agent can sell. The fact that it must be adapted to a wide range of business enterprises and exposures is a contributing factor to its inherent complexity.

Contractual liability
One of the exposures treated by the CGL policy is contractual liability. As with many coverages provided in the policy, contractual liability emerges from an exclusion—or rather an exception to an exclusion. Exclusion 2.b first carves out all bodily injury and property damage payable by the insured because of his assumption of liability in a contract or agreement. Then the exclusion leaves untouched, by way of exception, the liability assumed in an "insured contract" and the liability that exists in the absence of a contract.

The first exception is what we call the contractual liability coverage, with the second exception just clarifying the exclusion's intent not to disturb coverage that has been independently provided in the policy.

Insured contract
The key to understanding the contractual liability of the CGL policy is in knowing what an "insured contract" is. For this, an excursion into the definition section of the policy will be necessary. There we find a list of six contracts and some more exclusions. Rather than biting off more than can be chewed, only the first covered contract has been selected for discussion in this Resource Kit.

Leases
A lease of premises is a covered contract. A significant number of businesses must lease premises in order to conduct their necessary operations. From a risk management point of view, a lease represents potential liability for the business owner. Liability from a lease is usual and customary and, therefore, a natural subject for coverage in the CGL. However, the coverage provided for a lease does not necessarily include all liability that a lessee assumes. Performance on the terms of the lease is one potential liability that is not covered. Despite what the name might imply, contractual liability coverage does not include exposures relating to a breach of contract.
**Lease provisions**

Before we place boundaries around the lease coverage in the CGL, a word of caution is appropriate. It is not enough for an agent to know what the CGL covers for liability assumed in a lease. It is equally important to know what exposures the lease creates for the insured. Although there is some standardization to be found in lease provisions, the agreement between lessor and lessee is limited only by their needs and the creativity of their attorneys. (You may have noticed that many attorneys prepare leases that are ambiguous with respect to insurance terms, making it difficult to assess the exposure.)

**Inspection**

You can never assume anything about a lease. I do not know how an agent can properly serve his client without attempting to ascertain the extent to which liability has been incurred in the lease. Am I suggesting that an agent inspect the leases of each of his clients? Yes. Even the insured's attorney may overlook an exposure that an agent has been trained to recognize. The agent may not be able to obtain the protection necessary to eliminate all of the exposures found in the lease, but at least the insured can be informed and given an opportunity to treat them in a rational manner.

**Third-party liability**

Typical exposures in a lease involve the physical property relating to the tenancy and third parties who are affected by the tenancy. Each of these exposures has limited protection in the coverage provided by the CGL. The one which truly represents contractual liability, and receives the broadest treatment, is the third-party liability of the lessor which is assumed by the lessee. Remember, the lessee's own liability is covered independently. It is the liability incurred by the lessor that the lease may be transferring to the lessee, which means that the lessee is holding the lessor harmless for its responsibilities to third parties.

**BI and PD**

According to the terms of the contractual liability coverage, the liability to third parties is restricted to bodily injury and property damage, as defined in the policy. Absent is the legal liability for all other kinds of damages, including mental anguish, discrimination, sexual harassment, government fines, wrongful discharge, advertising injury, personal injury, etc.

Take note that the lease of premises coverage is not restricted to assumed tort liability, as are other insured contracts described in item (f) of the definition of insured contract. As a consequence, assumed contractual liability involving bodily injury and property damage would be covered in addition to tort liability.

**PI and AI**

You may be tempted here to plead coverage under Coverage B—Personal and Advertising Injury Liability. However, exclusion 2.a.(5) of that section makes it clear that this type of liability assumed under contract is not covered. ISO has available an endorsement CG 22 74 Amendment of Contractual Liability Exclusion For Personal Injury which will restore only the three personal injury offenses of false arrest, detention and imprisonment. Needless to say, a lease which transfers legal liability for other than bodily injury and property damage should receive special attention.

**Property risk**

The physical property, which is the subject of the tenancy, holds value to the lessee while his legal right to occupy exists, as well as to the lessor/owner. Traditionally, the lessor/owner insures the property. After all, his interest transcends that of any tenant. But because buildings are particularly
vulnerable to fire damage and its causation frequently is attributable to the occupancy of the tenant, many leases simply make it clear that the lessee will be held liable for fire damage resulting from his negligence. (Take note that the property insurer has rights of subrogation against the negligent tenant anyway.) Since the potential for loss is quite severe, this exposure gave birth to the so-called fire legal liability coverage.

**Fire legal liability**
Fire damage coverage on occupied property is an aberration of liability coverage. The care, custody, and control exclusion of most liability policies precludes coverage from damage to such property. In the case of the CGL policy, exclusion j.(1) specifies "property you own, rent, or occupy" as excluded from property damage. However, the common, but severe, exposure to fire damage highlighted in many leases finds remedy in the exception to exclusions c through n for damage by fire to premises "rented to you or temporarily occupied by you." This exception constitutes the fire legal liability coverage in the CGL policy.

**Comments**
Several more comments need to be made about fire legal liability coverage. First, coverage is limited to property rented or temporarily occupied. A policyholder occupying property not fitting the description expressed in this exception would be uninsured for fire damage to that property. Second, the maximum CGL limit for fire damage under ISO rules is $100,000. Third, just because fire damage to property rented has been restored by the exception, it does not incorporate liability beyond the negligence of the lessee/insured. Although the lease is a covered contract and fire damage to rented or temporarily occupied property is not excluded, liability assumed in the lease for fire damage not caused by the negligence of the lessee/insured is still excluded. The definition of an "insured contract" eliminates in (9.a.) "that portion of the contract for a lease of premises that indemnifies any person or organization for damage by fire to premises while rented to you or temporarily occupied by you." Therefore, contractual liability coverage does not include fire damage to rented premises.

**End result**
What we end up with for lease protection in the CGL policy, beyond the lessee's own tort liability, is contractual bodily injury and property damage liability to third parties and coverage for some negligent fire damage (capped at $100,000) to the premises. Not covered by the CGL policy is liability for performance on the terms of the $100,000 lease; that is, liability for breach of contract.

Unfortunately, modern leases have gone beyond the scope of protection afforded by the CGL policy, sometimes inadvertently. This is particularly true with regard to liability for damage to the premises. If fire is the only peril that the lease holds the tenant legally liable for, and the potential for combined damages to the property and loss of use does not exceed $100,000, no further solution is necessary. But for the balance of this article, we are going to be concerned with liability incurred beyond these parameters.

**Range of lease provisions**
In order to appreciate the insurance problems that leases can create for tenants, it will help to survey the variety of provisions to be found. The lease could specify that the lessee purchase and maintain a property policy covering designated perils, regardless of fault. Another option is to hold the lessee liable for negligence which results in damage from certain perils. Or the lessee could just accept liability for damage which exceeds the coverage limits of the landlord's policy.
And at one extreme, the lessee may be required to return the property at the end of the lease in the same condition as it was when turned over to the tenant at the beginning of the lease. Just think of the uninsurable exposures this language could lead to—war, wear and tear, termites, contamination, nuclear hazard, etc.! Most leases will have standard provisions that can be treated adequately with insurance, but there is always the possibility that the landlord's attorney got creative to justify his fees.

**Five options**

There are basically five different approaches that the lessee can take to protect himself from liability for damage to the property which is the subject of the lease. Each must be evaluated on its merit in terms of cost, extent of protection, the cooperation required of the landlord, and its overall ease of implementation.

- **Property policy.** Because a tenant can have a use interest in leased property, in addition to an interest based on legal culpability for damage caused by negligence or liability assumed in the lease, a tenant has an enforceable insurable interest in such property. Some courts acknowledge an insurable interest in the full value of the property.

  Consequently, a tenant may purchase a property policy to cover the extent of his interest in the property, as well as the interest of the landlord. An appropriate cause of loss form would be chosen to cover the perils indicated in the lease.

  Should the tenant fail to add the interest of the landlord to his policy and breach this obligation in the lease, there is no protection afforded by the contractual liability coverage of the CGL policy. Neither would the tenant be protected if the wrong peril form was selected, resulting in an uninsured loss for which the lease holds the tenant accountable. These kinds of oversights can lead to errors and omissions claims against agents.

  The major drawback to this option is the cost born by the lessee. And if the landlord maintains his own policy, there is wasteful duplication of coverage.

- **Legal liability policy.** If the tenant is not obligated by the lease to provide primary coverage on the property, but is going to be liable for his own negligence in causing the landlord to incur a loss, then the preferred choice of policy is the Legal Liability Coverage Form (CP 00 40). This policy can be purchased with the same choice of perils as the Building and Personal Property (BPP) coverage form, but at a fraction of the cost. In fact, the cost is one-quarter of the 80 percent coinsurance building rate. The coverage also will incorporate consequential (loss of use) damages as long as the limit of liability is sufficient.

  The protection provided by the Legal Liability Coverage Form is described in the ISO manual as: "Coverage for damage for which the insured is legally liable arising from direct physical loss or damage, including loss of use, to tangible property of others in the insured's care, custody or control up to the limit of insurance shown in the declarations."

  Defense costs and many of the usual supplementary payments found in liability policies are covered in addition to the limit of liability. However, damages are payable only for tort liability, not merely because the responsibility for loss was assumed by contract. Although there is no coinsurance requirement, care should be taken to select a limit that will encompass the entire exposure for damage to the property and its loss of use.
Tenant as additional insured. In order to block the landlord's insurer from subrogating against the tenant for losses covered by its policy, the tenant could be named as an additional insured on the landlord's policy. As stated previously, a tenant does have an insurable interest in the property under lease.

Also, take note that with regard to business personal property, the "no benefit to bailee" provision found in the Commercial Property Conditions form (CP 00 90) would not apply to an additional insured.

Several problems can occur with this approach. First, the tenant may not be able to control the coverages provided in the policy, creating the possibility that protection would not be adequate to cover his exposure in the lease. Second, the landlord may not want to take responsibility for updating the policy with additional insured endorsements, especially if multiple tenants in the building are involved. Third, the landlord may not want settlements under his policy encumbered with the interests of the tenant. And fourth, the "concealment, misrepresentation or fraud" provision (CP 00 90) may create problems for all insureds, when possibly only one insured actually breached the provision.

Waiver of subrogation. This could be a very sensible noninsurance remedy for both parties. The landlord and the tenant could agree in writing to release one another for liability for a loss negligently caused by either party to the property of the other. Both parties would be responsible for maintaining their own policies with adequate protection. The transfer of rights of recovery against others to us provision (CP 00 90) even allows the landlord to waive subrogation rights against a tenant after the loss has occurred. (A sample mutual waiver of subrogation agreement is shown on page 5.)

One potential glitch in this solution occurs when an inland marine policy is involved. The policy conditions in this form do not specifically permit the insured to waive the insurer's subrogation rights. (There are ways around this problem with inland marine forms or nonstandard property forms.) Also it is important to make sure that the tenant has not retained any exposures that are not addressed in the waiver.

Revise the lease agreement. A final and obvious solution is to revise the lease so as to relieve the tenant of all liability for damage to the landlord's property. However, landlords willing to do this might be a little scarce. Variations may be found which relieve the tenant from his liability in the absence of willful and wanton negligence or his liability up to the amount of collectible insurance carried by the landlord.

Costly assumptions
There is a variety of methods to solving lease problems, just as there is a variety of exposures created by leases. Like most problems, awareness is the key to solving them. Your professional objective to reduce your customer's exposure to loss requires that neither you, nor your client are uninformed about the liabilities assumed in a lease of premises.

Mutual waiver of subrogation
In the event of physical damage to the lessor's property or to the lessee's property for which either party is insured, or is required to be insured according to terms specified elsewhere in the lease, the lessor and the lessee mutually waive their rights to subrogation and recovery against
each other, their agents, employees, or sublessees to the extent that they are insured or are required to be insured. It is the responsibility of each party to obtain assurance from its own insurer that such waiver will not invalidate the coverage afforded by its insurance policy.

The lessor agrees to maintain insurance against loss from physical damage to its owned real and personal property located on the demised premises, as well as the consequential loss of rents from such physical damage. This insurance shall cover all perils included in the Insurance Services Office Inc. cause of loss—special form CP 10 30 (or the equivalent offered by its insurer). All property shall be insured for its replacement cost in sufficient limits to cover 100 percent of its value without incurring a coinsurance penalty. Loss of rents also shall be insured for its full value during a reasonable period of restoration.

The lessee agrees to maintain insurance against loss from physical damage to its owned personal property and the personal property of others in its care, custody and control located on the demised premises, as well as the consequential loss of income and extra expenses incurred from such physical damage. This insurance shall cover all perils included in the Insurance Services Office Inc. cause of loss—special form CP 10 30 (or the equivalent offered by its insurer). All property shall be insured for its replacement cost in sufficient limits to cover 100 percent of its value without incurring a coinsurance penalty. Loss of income and extra expenses also shall be insured for their full value during a reasonable period of restoration.

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