

## Law & Accounting

# Lease insurance provisions: The law behind the clause

Leasing lawyers fight tooth and nail about the extent to which landlords can pass through management fees as an “operating expense,” will redline back and forth whether a tenant should remove its cabling upon surrender of a premises, and will go to bat over the number of business days reserved for a tenant to cure a default – but when it comes to one of the most important provisions in a leasing relationship, lawyers often punt.

It’s important for leasing lawyers to understand the required coverages and ramifications of those coverages on the rest of the lease terms. While it’s important to consult with your client’s risk management team, relying solely on its expertise ignores important nuances that leasing lawyers can catch and can potentially lead to a misallocation of risk in the agreement.

■ **Policy availability.** Commercial leases often require landlords and tenants to carry a variety of insurance coverages, but the coverages generally fall into classifications of either liability insurance, which provides coverage for losses



**Tal Diamant**  
Shareholder,  
Brownstein Hyatt  
Farber Schreck LLP

incurred by third parties, or property insurance, which provides coverage for damage to real or personal property owned by the policyholder.

- **Liability.** Basic coverages afforded by commercial general liability policies include coverage for damage or loss resulting from bodily injury and property damage, with coverage available for personal and advertising injuries, and medical payments under an “umbrella” policy. Limits for commercial general liability policies are typically from \$1 million to \$10 million, with excess coverage available to insure larger claims.

- **Property.** Property insurance is offered in Basic Form coverage, Broad Form coverage or Special Form coverage. Unlike Basic Form and Broad Form coverage, which only insure losses resulting from specific perils, Special Form coverage, which is most com-



**Miranda Norfleet**  
Associate,  
Brownstein Hyatt  
Farber Schreck LLP

mon in commercial leasing, covers losses incurred in connection with all causes except those that are specifically excluded. Excluded losses are those incurred in connection with boiler and machinery, earthquake and flooding. Additional coverages are available to complement Specialty Form coverage – a policy known as “difference in condition” offers coverage for earthquake and flooding, but is typically very expensive; a policy known as “builder’s risk” offers coverage during construction and repair; and a policy known as “mechanical breakdown” offers coverage for the policyholder’s maintenance and repair obligations under a lease, including heating, ventilation, air conditioning, transformers and other mechanical equipment. Endorsements are available to provide coverage for business

interruption for tenants and rental loss for landlords. Coverage under property insurance policies offers are available as: (i) “actual cash value,” which provides coverage based on the value of the property at the time of the loss, determined based on the replacement cost, less depreciation, calculated over the useful life of the property; (ii) “replacement cost,” which provides coverage without reduction for depreciation (but does not cover excavation, foundation or footings); or (iii) “functional replacement cost,” which provides coverage for a functional-equivalent improvement that can be built for less. Replacement cost coverage is the most common coverage required in commercial leasing, but functional replacement cost coverage may offer significant cost savings to the policyholder.

■ **Application in commercial leasing.** With respect to both liability insurance and property insurance, leasing lawyers should consider with their clients which party will carry coverage with respect to the premises and with respect to any common areas benefiting the premises. Often, leases

will require tenants to maintain liability coverage with respect to the premises and landlords to maintain such coverage with respect to the common areas, but that’s certainly not always the case. Lawyers should negotiate insurance obligations appropriately considering the negotiated maintenance obligations, casualty and condemnation provisions and indemnities under the lease. For example, if a tenant receives an indemnity from a landlord with respect to losses incurred by third parties in the common areas, then the landlord should carry liability insurance with respect to the common areas. Or, if a landlord proposes that a tenant accept responsibility for reconstruction following a casualty, then the tenant should carry property insurance for the premises’ full replacement cost, or the landlord should be required to transfer proceeds from its policy to the tenant for such purpose. And if a tenant requests a rent abatement during the repair of its premises following a casualty, then the landlord should obtain rental loss insurance to protect its

Please see **Diamant**, Page 25

SVC

SENN VISCIANO CANGES P.C.

OUR REAL ESTATE GROUP

*Serving the Commercial Real Estate Community*

- LEASING
- REAL ESTATE DEVELOPMENT
- REAL ESTATE ACQUISITION
- ENVIRONMENTAL
- PRIVATE EQUITY
- COMMERCIAL LENDING, WORKOUTS AND FORECLOSURE
- REAL ESTATE AND COMMERCIAL LITIGATION
- CONSTRUCTION CONTRACTS AND LITIGATION
- CORPORATE

Our clients rely on our experienced team of lawyers to guide them through all of their legal needs, from significant business decisions to the most complex global deals and litigation. Our breadth and depth of practice enable us to handle the most complex matters and solve our clients’ problems seamlessly.

1700 Lincoln Street, Suite 4300 | Denver, Colorado 80203  
Phone 303-298-1122 | Fax 303-296-9101

[www.SennLaw.com](http://www.SennLaw.com)

Assisting clients with the

**ACQUISITION,  
FINANCING,  
DEVELOPMENT,  
LEASING,  
& DISPOSITION**  
of all types of  
**REAL PROPERTY**

DAVIS  
GRAHAM &  
STUBBS  
dgsllaw.com

**Catherine Hance**  
303.892.7375  
catherine.hance@dgsllaw.com

