NEVER SEND A TENANT TO DO A LANDLORD'S JOB

Rethinking the "hands off" approach to insurance in Triple Net Leases

Perhaps a more appropriate title for this article would read: "*never trust someone else to insure your asset.*" Common sense, right? Not always in the context of commercial leases. When it comes to certain types of commercial leases, most notably the *Triple Net Lease* ("TNL"), it is actually the norm for a landlord to pass insurance responsibilities on to the tenant. As this article will explain, the "normal way" is not the best way, and any landlord that trusts a tenant to properly insure its building is (almost literally) "playing with fire."

> ***"NEVER TRUST SOMEONE ELSE TO INSURE YOUR ASSET."***

Under traditional leases, tenants are generally only responsible for insuring the units they occupy and the personal property therein. The landlord then insures the structure itself, common areas, and any unoccupied units. With a TNL, however, the responsibility for insuring the entire building is typically shifted on to the tenant(s) under the terms of lease and/or pursuant to a common area maintenance agreement ("CAM"). The appeal of a TNL is obvious as it allows the landlord to simply sit back and collect rent payments by ridding itself of the responsibilities/costs associated with the building. What could possibly go wrong? Simple answer, A LOT.

To start, what happens if the landlord's building burns to the ground and it is discovered after the fact that the tenant: (1) failed to take out the proper policy; (2) failed to pay the premiums on time; or (3) canceled the policy. In those situations, the landlord could be left with an uninsured pile of ash. Moreover, lease provisions requiring the landlord to be listed as an additional insured or loss payee can easily be overlooked, forgotten, or misstated,

with the oversights not being discovered until after a loss. Also, if coverages, exemptions, and endorsements are not carefully reviewed, a landlord could find itself unpleasantly surprised by the scope and coverage of the policy "protecting" its building.

In addition to the landlord's interest, the tenant will almost certainly have other lien holders as "loss payees." A loss payee is a party entitled to all or a portion of insurance proceeds in the event of a loss, even though they are not a named insured. Loss payees are generally paid before or in conjunction with insureds. What this means is that reconstruction/repair of the building could be delayed until the tenant's machinery/equipment lien holders are paid. In an extreme case, a landlord could find that insufficient proceeds remain for the proper repair or reconstruction after payments to the tenant's other loss payees are made. This would leave the landlord in the precarious position of having only a claim against the tenant to try and recoup the deficiency. Collectability concerns abound.

The worries do not stop when a tenant secures the correct coverage and timely pays the premium, as coverage can still be voided or denied at no fault of the landlord. Our firm was recently made aware of a circuit court case where a landlord (who was actually listed as a "loss payee") permitted the tenant to insure its building under a TNL. After a fire destroyed much of the building, the insurance company denied coverage to all on the basis that: (1) the tenant was found to have caused the damage; (2) the tenant failed to cooperate with the insurer; and (3) the tenant did not have a genuine insurable interest in the property. Consequently, the landlord was left with no building, no coverage, and no legal standing to pursue the insurance company. The moral of the story is that the acts of a tenant alone can potentially void or cause denials of coverage on the landlord's building.

Taken all together, the traditional "hands off" insurance arrangement of a TNL is hazardous because it places unwarranted trust in a tenant to protect an asset in which it has no interest in outside of the lease. That alone should be reason enough for a landlord to always possess its own commercial policy. Accordingly, the safest approach when dealing with TNLs is for the insurance to flow through the landlord. The landlord can still pass the costs of said insurance on to the tenant(s) by requiring reimbursement as additional rent in the lease, or as an expense under the CAM, but the landlord should never pass on the responsibility. By the retaining this easy control over insurance, a landlord is able to avoid potential pitfalls and the devastating consequence of being left with an uninsured pile of ash.

If you have concerns about your commercial property, please contact our office and we will be happy to answer your questions or review your lease language.

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