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WHAT'S COVERED? INSURANCE AND INDEMNITY CLAUSES IN LEASE AGREEMENTS

Richards Buell Sutton Insurance Newsletter

By: C. Nicole Mangan

Lease agreements often anticipate specific risks and include provisions to try and ensure that one or both parties are adequately insured or indemnified if certain contingencies arise. Multiple provisions in the lease may address similar issues resulting in the need to interpret both a specific term and its interaction with other terms. After a fire, the Ontario Court of Appeal was asked in *Deslaurier Custom Cabinets* v. *1728106 Ontario Inc.*, 2016 ONCA 246 to interpret the meaning of, and the interaction among, multiple insurance and indemnity provisions.

Facts

A fire occurred on January 1, 2009 which destroyed the premises leased by Deslaurier Custom Cabinets and caused significant damage to the Landlord's building. A welding contractor was conducting repairs at the Premises when welding splatter, or slag, ignited causing the fire. Insurance was purchased by the Tenant for damage to its property before it entered the Lease. In breach of the Lease terms, the Tenant did not add the Landlord to that policy as an additional insured. The Tenant was paid over $10 million by its insurer for damage to its property and business caused by the fire, however, it was under-insured and it claimed against the Landlord and the welding contractor for over $4 million in uninsured losses. The Tenant's insurer made subrogated claims against those parties for the amount it paid. A summary trial addressed whether the Lease provisions should result in the claim against the Landlord being dismissed or in the Landlord indemnifying the Tenant for its losses. The trial judge concluded the Landlord was obligated to indemnify the Tenant, and the Landlord appealed.

The Lease Provisions

In summary, pursuant to various clauses of the Lease:

- The Landlord was obligated to insure the premises and its property against a number of specific perils, including fire.
- The Landlord also indemnified the Tenant against "damage to the Premises occasioned by or arising

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from the act, default or negligence of the Landlord, [or] its . . . contractors" (the "Landlord's Indemnity Covenant").

- The Tenant was obligated to:
    - carry insurance against "All Risks of loss or damage to the Tenant's property";
    - carry insurance covering damage to its property caused by fire;
    - carry business interruption insurance; and
    - include the Landlord as an additional insured on both its liability and property damage policies;

(collectively, the "Tenant's Insurance Covenants").

- The Tenant also indemnified the Landlord against claims for damage to person or property "arising out of or occasioned by the maintenance, use or occupancy of the Premises".
- Finally, the Tenant agreed, except "as otherwise specifically provided for in [the] Lease", that it was not "entitled to claim against the Landlord for any damages, general or special, caused by fire" (the "Immunity Covenant").

The Law and The Ruling

When either party to a lease agrees to obtain insurance for a specific risk, then the courts have held that covenant to insure runs to the benefit of the other party and relieves it from liability for that risk. This applies even where the other party's negligence caused the risk, such as a fire, to occur. In this scenario, the party with the insurance specified in the lease is expected to look to its insurer if the risk occurs – not to the other party.

In a subrogated claim, a party's insurer can be in no better position than the party itself. Where lease terms prevent one party from suing the other, they also bar a subrogated claim by that party's insurer. A related insurance principle is that an insurer cannot subrogate against its own insured. Naming both the landlord and a tenant in an insurance policy therefore also prevents a subrogated claim from being brought by that insurer against either party. A party to a lease also cannot benefit from its own breach of the contractual obligation to name an additional insured and, likewise, nor can its insurer.

Relying on all the above principles, as well as the Tenant's Insurance Covenants and the Immunity Covenant, the Landlord argued it was sheltered from the Tenant's claims. The Tenant argued the Landlord's Indemnity Covenant, by providing indemnity for the negligence of the Landlord's contractor, was paramount to these other clauses. The Tenant argued the Landlord's Indemnity Covenant was something "specifically

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provided for in [the] Lease", therefore, the Immunity Covenant did not apply. The trial judge favoured the Tenant's arguments, however, the Court of Appeal concluded that the Landlord's position was correct.

The appeal court held that the Tenant's Insurance Covenants required the trial judge to impose the allocation of risk agreed to in those terms first. Only then could consideration be given to whether other lease terms altered the result. Applying this, the Landlord's Indemnity Covenant would only address risks not covered by the Tenant's Insurance Covenants. Close consideration was also given by the appeal court to the specific wording of the Landlord's Indemnity Covenant which related to damage to the "Premises". At trial the Tenant argued, and the court accepted, that "Premises" must include the Tenant's property to have meaning because the Tenant had no other legal interest in the "Premises". The Court of Appeal concluded this was an error. Including the Tenant's property in "Premises" was inconsistent with the use made of that term throughout the Lease and the Tenant had both a leasehold interest in the Premises and an interest in its trade fixtures.

Four simple conclusions ultimately enforced the Tenant's obligations, did not strain the meaning of "Premises", and gave both meaning and a harmonious reading to all of these provisions.

1. The tenant had to obtain certain insurance.
2. For those risks, it had to look to its own insurer.
3. For any risks the tenant was not obligated to insure against, that arose from the landlord's negligence (or its agent, contractor, etc.), the Landlord's Indemnity could apply.
4. There was, however, no indemnity for the risks specifically identified in the Immunity Covenant regardless of whether the Tenant had to insure for that risk.

Conclusion

Ensure you comply with any lease provisions relating to insurance. Parties can be held to the effects of these obligations, with potentially significant consequences, regardless of whether they comply. Insurance provisions, as in this case, will likely apply first with indemnity provisions interpreted for the meaning they have after insurance provisions are applied. Only very specific language will override the impact of an obligation to insure.

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