Issues in Negotiating Risk Transfer Provisions in Retail Leases—Practical Considerations

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Two of the most common and regularly negotiated risk transfer provisions in any lease are those involving indemnification and insurance. It is by these requirements that the landlord and tenant seek to allocate risk between each other related to the tenant's use of the leased premises, and sometimes other portions of the retail center in which the premises are located. The purpose of this article is to identify recurring issues related to these provisions and practical considerations for practitioners during the negotiation and drafting of these provisions in retail lease agreements.

Indemnification and Insurance Are Interrelated Provisions

Indemnification provisions require that one party indemnify or hold harmless another party in the event of some future damage, loss or other injury. In California, for example, indemnity is defined as follows:

> Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person.
> (California Civil Code §2772).

From a risk-management perspective, indemnity and insurance provisions have always been interrelated. On the one hand, indemnification allocates liability between a landlord and tenant for certain risks; that is, should an accident, injury, fire or other property damage occur on the premises and/or other portions of the shopping center and such an event is caused by the tenant, landlord, or one of the parties for which the landlord or tenant is responsible. On the other hand, insurance is intended to provide a financing mechanism to pay for such risks, in addition to any economic resources of the responsible party (or parties).

The relationship between indemnification and insurance provisions has become even more considerable in light of the recent changes made in commercial general liability insurance forms for additional insureds. As recently noted in *Retail Law Strategist,* as of 2013, the limits of the additional insured's coverage will now not exceed the limits of the insurance coverage that the tenant or contractor is required to maintain in the lease. (*See* Moore, Marie. "New Insurance Forms Have Impact on Additional Insureds," *Retail Law Strategist,* Spring 2014). This means that, irrespective of any commercial general liability limits maintained by a tenant, a landlord will be limited to the specific limits required in the lease itself.

Limitations on Indemnification

Any legal limitations on indemnification should be considered based upon the state

in which the shopping center is located. Although each state may have its own limitation on indemnification, with some dependent on the type of agreement containing the indemnity obligation, most states restrict or prohibit the indemnification for one's own willful misconduct or actions in violation of law. In California, such an indemnity provision would be void as a violation of public policy. Civil Code section 1668 provides:

> All contracts which have for their object, directly or indirectly, ***to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent***, are against the policy of the law. (California Civil Code §1668, emphasis added.)

In addition to legal requirements, one should be careful that any indemnification provision is reviewed in detail with the insurance requirements and any specific coverages that a tenant may or may not maintain. For instance, some tenants may employ self-insurance for certain coverages, while other tenants may have insurance policies with a number of exclusions or other constraints on coverage that the tenant can provide for itself or to the landlord as an additional insured. This involves a thoughtful discussion between the landlord, tenant and counsel representing either party. It may include the insurance broker(s) for each party, depending on the complexity of the insurance issues at hand.

As suggested above, with respect to commercial general liability insurance, if the indemnification requirements of a tenant are broader than the insurance requirements, the tenant remains responsible for the liability and defense costs not covered by insurance. However, the landlord must look to the assets of the tenant to cover such costs, which may or may not be sufficient.

Tenant's Operations Outside the Premises

Generally, most indemnification provisions in leases allocate liability between the landlord and tenant as follows: tenant is responsible for any activities, injuries or damage occurring in the premises (unless caused by landlord), and consequently, landlord retains responsibility for activities, injuries or damage occurring in the premises (unless caused by tenant) and occurring in the common area(s). It is a point of negotiation between the landlord and tenant whether the landlord's indemnity shall be limited to the acts, omissions and/or negligence of the landlord, its agents, contractors or employees in the common area, or whether the landlord's indemnity shall include acts, omissions and/or negligence of third parties, such as other tenants of the shopping center, in the common area.

The insurance requirements of the tenant typically mirror the indemnification provision requiring the tenant to maintain commercial general liability insurance, including naming the landlord as an additional insured, for any liability arising out of the possession, use or maintenance of the premises by the tenant.

This apportionment between the tenant and landlord is logical based on the tenant's use of the leased premises for its operations. However, issues arise when the tenant's operations do not occur solely within the boundaries of the leased premises, which is often the case. Consider the following:

- Does the tenant display merchandise, regularly or on a seasonal basis, on the sidewalk adjacent to the premises or other portion of the common area?
- Are there tables located adjacent to the premises, a patio or other outdoor seat-

ing area used by tenant and its customers?

- Does the tenant have a band or other live entertainment perform within the outdoor seating area or have events within such an area; e.g., food or wine tasting?
- Is there a drive-through facility associated with the premises or a separate take-out food area with pedestrian or vehicular use?

If a customer in the shopping center is injured in one of these locations, all of which are located outside of the premises, and tenant did not directly cause the injury, i.e., the injury is caused by a third party, then tenant will have no indemnity obligation to the landlord and the landlord retains all liability for this type of injury. Moreover, as the insurance requirements of tenant were also restricted to the premises, this injury claim is likely not covered by tenant's insurance.

Actions of Other Tenant Parties

Lease indemnification provisions may only require that the tenant indemnify the landlord under certain circumstances. Yet, the tenant is not the only party that may cause injuries or damage in the premises. Most tenants hire independent contractors and other third parties to maintain certain portions of the premises (e.g., the premises' heating, ventilation and air conditioning equipment), to repair or construct improvements inside the premises and to deliver merchandise to the premises. Some of these parties may even frequent the premises and shopping center on a daily basis.

For these reasons, it makes sense for the indemnification provision to include these additional tenant parties, thus broadening the indemnification to make the tenant and these additional parties responsible for any activities, injuries or damage occurring in the premises and shopping center, if necessary, as discussed above. Correspondingly, the insurance requirements of the tenant should be expanded to name the landlord as an additional insured for any liability arising out of the possession, use or maintenance of the premises by the tenant and these additional parties.

Sample Negotiated Tenant Indemnification Provision

In a negotiated lease, the tenant's indemnity obligations may read similar to the following provision:

> ***Tenant's Indemnification of Landlord.*** Tenant will defend, indemnify, and save Landlord harmless against and from any real or alleged damage or injury and from all claims, judgments, liabilities, costs, and expenses, including reasonable attorney fees and costs occurring within (a) the Premises or (b) the Shopping Center to the extent caused by Tenant; provided that Tenant will not be liable for such damage or injury to the extent and in the proportion that the same is ultimately determined to be attributable to the negligence or misconduct of Landlord. This obligation to indemnify will include all of the foregoing incurred by Landlord from the first notice that any claim or demand is to be made or may be made, and Landlord will promptly notify Tenant of any actions, proceedings, claims, or demands for which Landlord requests indemnification from Tenant; provided that Tenant has no obligation to pay or reimburse Landlord for fees and/or costs of any counsel retained by Landlord (as opposed to counsel retained by Tenant on Landlord's behalf) to defend, analyze, or otherwise perform legal services relating to such defense or actions, proceedings, claims, or demands. (*See* Retail Leasing: Drafting and Negotiating the Lease §23.72 [Cal CEB 2013]).

The indemnification provision, in subsection (b), takes account of tenant's operations outside of the premises. Additionally, if the tenant will be utilizing contractors or others for maintenance services, this provision could be revised to include "to the extent caused by Tenant or Tenant's Agents," with "Agents" defined as the employees, agents, officers, directors, licensees, contractors and subcontractors of tenant, similar to the sample provision language below.

Sample Negotiated Landlord Indemnification Provision

If the tenant negotiates a reciprocal indemnity from landlord in a negotiated lease, landlord's indemnity obligations may be comparable to the following provision:

> ***Landlord's Indemnification of Tenant.*** Landlord will indemnify, hold harmless, and defend Tenant from and against any and all claims, actions, demands, expenses, and liability whatsoever, including reasonable attorney fees, on account of any such real or claimed damage or liability and from all liens, claims, demands, expenses, and liability occurring in the Common Areas, to the extent caused by the negligent or intentional act or omission of Landlord or Landlord's Agents. Tenant will promptly notify Landlord of any circumstance for which Tenant requests indemnification from Landlord. Landlord will have the right to assume the entire control of the defense thereof, and Tenant will cooperate fully with Landlord in such defense at Landlord's cost. "Agents" means the employees, agents, officers, directors, licensees, contractors, and subcontractors of such party. (*See* Retail Leasing: Drafting and Negotiating the Lease §23.74 [Cal CEB 2013]).

Again, this provision incorporates the landlord's use of contractors or others for cleaning, maintenance and like services within the common areas and landlord's responsibility for the actions of such parties.

Conclusion

In sum, while the indemnification and insurance provisions in any lease will need to be specifically drafted to reflect the business points and other details related to the tenant's proposed operations, the premises and retail shopping center at issue, practitioners are well advised to consider these issues thoughtfully when negotiating and drafting the indemnification and insurance provisions in the lease.

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