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Fire Legal Liability Insurance

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Fire legal liability" is a way to describe the risk that all persons, businesses, institutions, etc., are exposed to by way of responsibility for damage to property of others in their care, custody, or control. It requires special attention because forms providing property damage liability insurance—for example, the commercial general liability (CGL) form—usually do not apply to the exposure of property damage to personal property in the care, custody, or control of the insured.

The issue of fire legal liability insurance generally involves the following situations. The insured may be liable for damage to personal property, or for damage to real property, in his or her care, custody, or control. Occasionally the insured is liable for both.

First, when it comes to liability for damage to personal property in the insured's care, custody, or control, there are special forms (bailees type coverage) for the express purpose of insuring the property of others. Some, like laundries and dry cleaners coverage, the jewelers block form, and furriers' customers forms, provide *direct* (that is, regardless of legal liability) insurance on the customer's property. On the other hand, garage owners can purchase garagekeepers legal liability coverage that, as the name implies, provides protection to the garage owner for legal liability for damage to a customer's car (of course, garagekeepers coverage can be purchased to apply on a direct primary basis or a direct excess basis).

For other commercial insureds whose involvement with property of others is more in the way of an *incidental* nature, there is some protection in most forms (for example, the building and personal property coverage form, CP 00 10 06 07, provides an amount of direct insurance on property of others). However, instead of buying (where permitted) direct insurance on personal property of others, the insured can opt to purchase legal liability insurance for that property through the use of the legal liability coverage form, CP 00 40 06 07. The rate for this coverage is usually 50% of the 80% coinsurance contents rate—in contrast with 100% of the applicable contents rate for direct coverage—and is justified by the fact that the insurance applies only to losses for which the insured can be held legally liable.

On the other hand, the insured tenant may use the legal liability coverage form to provide insurance for both the building and the personal property of the owner. CP 00 40 states that the insurer will pay those sums that the named insured becomes legally obligated to pay as damages because of direct physical loss to covered property caused by accident and arising out of any covered cause of loss. Note that this can be *open perils* (not just fire damage) coverage should the insured choose that option. Also, "covered property" means tangible property of others, so both real and personal property can be covered under CP 00 40. As noted above, the rate for the premium under CP 00 40 is a percentage of the 80% coinsurance rate—25% of the 80% coinsurance rate for the building and 50% for the personal property.

Note also that the insured's CGL form will provide some fire legal liability coverage. The standard CGL form, CG 00 01 12 07, declares that the policy exclusions do not apply to damage by fire to premises while rented to the named insured or temporarily occupied by the named insured with permission of the owner. A separate limit of insurance applies to this coverage and is entitled "Damage to Premises Rented to You". This coverage is excess over the coverage provided by CP 00 40.

Whichever course the insured chooses, the bottom line is that insurers have a multiplicity of forms and methods available in order to provide proper insurance coverage at an acceptable price.

Fire legal liability coverage has not always been so readily available. Before the passage of the multiple line laws, a strict separation between fire insurance companies and casualty insurers prevailed, and the development of fire legal liability coverage could not proceed because there was little agreement between fire underwriters and casualty underwriters as to whether the insurance should be considered a fire line or one for a casualty company to handle. Both sets of underwriters asserted that there was no basis for rating the risk specifically; fire companies claimed they had no rating basis for *negligence* loading and casualty companies said they could not establish a *burnability* factor.

The absence of a ready market for fire legal liability insurance, particularly for real property in the insured's custody, gave rise to risk management tools like risk reduction or risk avoidance techniques such as the following, used singly or in combination.

The first of these techniques is to include the tenant as an additional insured in the property insurance covering the owner of the building. Practically all legal and insurance counselors agree that the *possible liability* of a party for damage to the property in question is an interest within the meaning of the standard fire policy and policies modeled on it. Similarly, it is now generally agreed that a tenant's *use* interest creates sufficient insurable interest. See, for an example of this type of legal thinking, *Aetna Insurance Co. v. Snider,* 437 S.W.2d 180 (Ct. App. Ky. 1968)—an old case but still good law. In this case, Snider obtained an insurance policy on a building he leased, in which he operated a restaurant. When the building was destroyed by fire, the claim was denied on the grounds that he had no insurable interest in the building. The Kentucky appellate court found that "an insurable interest [is one in which] the person insured will derive pecuniary benefit or advantage from its preservation or will suffer pecuniary loss of damage from its destruction." Under this type of reasoning, adding the tenant keeps the insurer from maintaining a subrogation action against the tenant, because the insurer would also basically be protecting the tenant's interest.

There are, however, several practical drawbacks to this procedure. It is obviously impractical in case of a multiple occupancy building to add each tenant, or to endorse the policies every time a tenant changes. Even if the entire building were leased to a single tenant, many landlords object to anyone else being involved in their insurance and, where the building is mortgaged, financial institutions have raised the same objection. Finally, even if no such objections arise, the tenant still has no protection against suits by the landlord for losses in excess of the amount of insurance recoverable, loss of rents, and other consequential losses. Fire legal liability insurance—since the coverage includes loss of use—could be a partial answer to this set of problems. The second risk reduction technique is to have the subrogation clause in the landlord's fire insurance policies waived, or to have it amended so that it does not apply to claims against the tenant.

Many property forms include permission—either direct, or implied because not prohibited—for such a waiver. For example, the commercial property conditions form, CP 00 90 07 88, contains a condition concerning the transfer of rights of recovery to the insurer. Under the coverage part, the insurer has subrogation rights when payment is made to or for any person or organization, the named insured or any other party. It clarifies the point that the insurer takes over the subrogation rights of not only the named insured, but also those of any party claiming indemnification, but only to the extent of payment made to that other party. However, CP 00 90 also states that the insured may waive his or her (and thus, the insurer's) rights of recovery against another party if the waiver is made in writing (1) before a loss; or (2) after a loss when the other party is another insured on the policy, a business owned or controlled by the insured or owning or controlling the insured, or a tenant of the insured.

A third risk management technique is to revise the lease to exempt the tenant from liability for fire (and perhaps other) damage (or write it this way in the beginning, if possible). Many standard printed leases include sweeping assumptions of this liability, but legal cases indicate that the simple expression "loss by fire. . .excepted (from the obligation to return the premises in the same condition as received)" will relieve the tenant of this liability.

A simple waiver, which will serve in most cases and which is more specific than that described above, is as follows: "it is mutually agreed, in consideration of the rent to be paid and the other conditions of this lease, that the lessee (or whatever term is used to designate the lessee) shall not be responsible for damage to the premises by fire."

However, it is frequently difficult, if not impossible, to get the owner to agree to amend the lease. This is particularly true where the property is owned by an estate or by a large corporation with inflexible renting policies. Insureds with favorable long term leases are often understandably hesitant about reopening negotiations with their landlords.

If the lease is amended *before* the fire insurance policies go into effect, it will not impair the protection of the landlord, since courts have held that an insurance company under the subrogation clause takes only such rights as the insured (landlord in this case) has. Instructive cases (old cases but still good law) on this point include *Pelzer Manufacturing Company v. St. Paul Fire & Marine Insurance Company,* 41 F. 271 (C.C.D.S.C. 1890) and *United States Fire Insurance Company v. Phil-Mar Corporation,* 139 N.E.2d 330 (Oh. 1956). Basically, because the landlord has waived the right to sue the tenant for fire damage prior to a loss, the right to sue then cannot be passed to the insurer. Moreover, many courts adhere to the idea that subrogation should not be available to the insurance carrier because the law considers the tenant as a co-insured of the landlord absent an express agreement between them to the contrary. This idea is derived from a recognition of a relational reality, namely, that both the landlord and the tenant have an insurable interest in the rented premises—the former owns the fee and the latter has a possessory interest. (This is termed the "Sutton approach" based on the case of *Sutton v. Johndal,*532 P.2d 478 (1975)).

If the lease is amended after insurance has gone into effect, the law is not as clear. Many legal authorities believe that it still will not affect the landlord's protection, but, to be absolutely safe, many insurance professionals recommend notifying each insurer on the line and getting its assent. For more information on the legal reasoning on both sides of the question, see *Seaco Insurance Company v. Jaime Barbosa*, 761 N.E.2d 946 (Sup. Jud. Ct. Mass. 2002).

Some attorneys feel that if the lease agreement is modified to make the tenant liable only for loss of or damage to premises due to willful and wanton negligence, the tenant's exposure would be considerably reduced. Others have suggested that the lease agreement be amended to provide that the tenant is relieved of liability up to the amount of collectible insurance carried by the owner on the premises and, in the event of any excess loss, the tenant is liable only for that excess. Obviously, all landlords will not be agreeable to such amendments, even though an insured tenant can point out that such excess coverage exists for fire damage to rented premises under the CGL form.

Now, since the right of subrogation arises for the benefit of the insurer, it may waive this right. Notice is unnecessary if the policies contain permission (as, for example, the permission offered by CP 00 90) for the insured to waive the subrogation clause with a written agreement in favor of any party.

The final risk management method used is that of the lessee purchasing separate insurance on the portion of the premises he or she leases. This is in line with the same principle expressed in the first alternative—that the liability or use interest of the tenant is an insurable interest. This method is now little used since the lessee can purchase fire legal liability insurance at considerably less cost.

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