



## Insurance: What you don't know can hurt you

By: **Julie Stulce Williamson and Marilyn C. Maloney**

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*Julie A.S. Williamson is a shareholder in the Miami office of the Florida firm, Akerman Senterfitt. She is a member of CREW Miami, is active on the ACREL Insurance, Leasing, and Nominating Committees, and serves on the planning committees and faculty of the Georgetown University Law Center Leasing Institute and the AECRE Annual Meeting.*

*As Past Chair of The Real Property, Probate and Trust Law Section of The Florida Bar, she has received both its Annual and Continuing Service Awards; current activities include the Title Insurance, Mortgage Law and Legislation Committees.*

*Marilyn C. Maloney has practiced in the New Orleans office of Liskow & Lewis for more than 25 years and is a frequent speaker on real estate related matters including insurance topics. She is a charter member of CREW New Orleans, a member of the American College of Real Estate Lawyers and currently serves as Chair of the ACREL Insurance Committee. Additionally, she is a Vice-President of the Louisiana State Law Institute where she serves on its mortgage and UCC drafting committees, and is a past member of the Board of Governors of the Louisiana State Bar Association.*

Do your eyes glaze over at the very mention of insurance? Do you snooze when the discussion turns to insurance certificates? Do you take the time to check whether your tenants or borrowers are complying with insurance requirements? Do you know where to turn for help?

*Be careful!* What you don't know about insurance can hurt you. Here are some important tips on timely insurance topics.

### **Insurance Binders: Here Today, Gone Tomorrow**

What does it mean when your agent binds coverage for a particular risk? Basically, an insurance binder is temporary insurance. The underwriter may even issue it while it is still carrying out due diligence to determine whether a particular risk or a particular property will be accepted for permanent coverage. The binder may contain an express expiration date, and the insurance laws of your state may provide a statutory limit to coverage. Therefore, coverage offered by a binder may terminate either because it has expired by its own terms or by law, or because the underwriter has affirmatively decided to reject the risk. State laws may determine whether a mortgagee, lessor, or other third parties are entitled to notification. The possibility that a binder could expire or be rejected without notice is a special concern for these parties. A survey of CREW members indicated that few landlords or lenders follow up to verify that policies have actually been issued.



### **Insurance Binders: Bound to What?**

Of particular interest now is what form of policy your insurer has bound itself to deliver. The World Trade Center litigation has focused on this issue. Coverage was bound but the actual policy had not been delivered at the time of 9-11. Insurers argued that the form of policy to be delivered would categorize the disaster as a single occurrence (a single act of terrorism) while the owner argued that the correct policy form would define it as two separate occurrences (two separate aircraft collisions). If the owner's view prevailed, of course, his recovery would be doubled! This is only one of many points critical to the insured and its lenders. Thus, if a particular form of policy is important it should be stated specifically, as should any particular endorsements (mortgagee, payee, etc.) that the insured expects to obtain.

### **Insurance Certificates: Only an Illusion?**

Most insurance certificates do not commit an underwriter to a particular coverage. On almost all ACORD forms, for example, there is language — look at the top right hand corner — stating that if the policy differs from the certificate, the policy controls. Therefore, if the certificate provides for loss of business income due to riots, but the policy only provides for loss due to riots that actually cause physical damage to the premises, the insured is not covered for business losses unless its actual premises is damaged. The ACORD 27 "Evidence of Insurance" does not have the disclaimer, and some underwriters will use it for both property and liability insurance.

### **Terrorism Coverage: An Update**

Congress finally passed the Terrorism Risk Insurance Act, providing a federal backstop against certain acts of terrorism (not unlike the flood insurance program). Many insurers are scrambling in order to write the required insurance, develop risk standards, and price the insurance. Don't expect it to be cheap, but do expect it to be available. This is good news to those with projects that have been put on hold because of the inability to obtain terrorism coverage required by lenders.

### **Impending Natural Disasters: Insurance Unavailability**

In some areas of the country, property insurance cannot be issued when a natural disaster — such as a hurricane — is predicted. Lenders will not fund purchases and other transactions without insurance being placed. It is prudent to specify in a contract that closing is contingent on the ability to obtain insurance, or that closing may be delayed until several days after the impending risk of a hurricane or other natural phenomenon has passed.

### **Business Income Insurance: A Big Part of 9-11 Claims**

Don't forget the importance of business income insurance. Insurance sources indicate that claims for business income and rent insurance are three times those filed for property loss of the twin WTC towers. Don't expect claims under business income to be easy. You can expect to be required to produce historical operating income and expense information to support your claims. One important tip: keep that information backed up and at a secure site, so that if your place of business is damaged or destroyed you will still be able to access the information needed to make your claim.



## **Landlords' Rent Insurance: When It Applies, What It Covers**

Landlords need the business income coverage, known as rent insurance, to cover times when tenants' rent is abated — such as when the building is not habitable due to damage or destruction. Leases may make tenants responsible for rent at all times. However, tenants, particularly small retail tenants, may not be able to pay rent if they are out of business and not properly insured for this contingency. A landlords' rent insurance does not cover rent that tenants owe but are not able to pay (the underwriter is not a collection agency). It may be surer, and easier to administer, if landlords provide in their leases that tenants' rent is abated in certain situations. Then the landlord can get appropriate coverage and can include the cost of such coverage in the operating expenses of which the tenants pay their proportionate share.

## **Tenants' Rent Insurance: The Elusive Full Coverage**

Tenants need to obtain rent insurance — and landlords should strongly consider requiring tenants to get it so that they have funds to pay their rent to the landlord — in an amount sufficient to cover their projected rent obligations while they are not able to operate out of their premises. This amount includes base rent and also CAM, operating expenses, taxes, and whatever else is passed on to the tenant under its lease. Tenants should also consider insurance for extraordinary expenses — the cost of temporarily moving to a new location, of moving back, or of paying higher rent in a temporary location. And in the event of serious damage, the repair and rebuilding may take a significant amount of time — the time for the landlord to negotiate its insurance settlement and to rebuild to the standard required under the lease, and the time for the tenant to build out and furnish its premises and to hire new personnel (if, for example, sales staff in a retail store have taken other jobs).

## **Where to Turn for Help**

These and other insurance issues require the involvement of a number of parties. First, the company's insurance broker is essential to help in understanding the different types of insurance and their requirements. In-house risk management officers should lead the examination of risk and risk tolerance and work with the broker to obtain the needed coverage. But the process cannot stop there. Officers, leasing agents, and attorneys must be involved to ensure that clauses in leases, loan agreements, construction contracts, and other contracts are consistent with insurance expectations. In addition to the clauses that identify insurance coverages and requirements, consider how clauses with obligations to maintain or repair property, to pay rent despite adverse circumstances, and to indemnify other parties can affect risk and coverage requirements. Additionally, once insurance is in place, in-house personnel must carefully monitor it. Not only should you monitor your own insurance but you also should have a procedure in place to monitor the insurance of third parties on whom you have imposed insurance obligations. Remember that obtaining a certificate or binder of insurance is not the same as obtaining a copy of a permanent insurance policy. To the extent possible, your staff should follow up to ensure that policies, containing the expected coverage, are delivered promptly.

What you don't know about insurance can hurt you, but with some time, effort and expert help, you can manage your insurance risks.