

Subrogation Clause in the Lease

--- Bryan K. Law BSc, FRI, CLO, PLE, MVA-Residential

Mr. Smith was going to a cruise in the US and unfortunately, the workers of the airline he booked his round trip tickets had a potential to strike. In order to guarantee to come back to work on time, Mr. Smith bought an extra return ticket from another airline. Although the workers in the original airline did not strike thus Mr. Smith wasted the money to buy the extra ticket, he had no regret in buying the 'guarantee' for his return.

In both commercial and residential leases, it is a standard to ask tenants to have their own insurance policy to cover their liability and contents. Most of the landlords will, on the other hand, have their own insurance policy to cover their liability and the building itself. For some condominium owners, although they have the building insurance included in the management fee, they will still buy an extra policy to cover their liability. This is an extra protection for the landlords just in case the policies that their tenants bought are expired or for some reasons are terminated, the landlord will still get insurance to cover them. This is similar to what Mr. Smith did to buy an extra 'guarantee'. The cost of such insurance will be paid by the residential landlords, but not the tenants. However, most commercial landlords will have such cost transferred to their tenant as common expenses, commonly known as CAM (common area maintenance) or TMI (taxes, maintenance and insurance).

If both of the landlord and the tenant buy insurance for their own coverage, there will be some overlapped coverage between the two insurance policies. For example, if there is an accident inside the tenant's unit and causes damages to the building, then both the landlord and tenant can file a claim to their insurers (insurance companies) respectively. The common practice is the landlord will file a claim to his/her insurer and the insurer will pay for the compensation. However, the landlord's insurer will claim the money back from the tenant's insurer since it is the tenant's fault. The premium of the tenant's insurance policy will then be increased because of this claim.

The question is: The tenant has paid the premium for the landlord's insurance through the common expenses and if landlord claims the compensation based on that policy, why should the premium of tenant's own insurance policy be increased?

Subrogation is the reason! Subrogation is the insurer's right to take the role of the insured (the landlord) that has been compensated and against the other (the tenant) who should be responsible for the damage. Although a landlord claims the damage through his/her own insurer, the insurer can collect the money back by filing another claim against the tenant to the tenant's insurer. Ultimately, it is the tenant's insurer to pay for the damage and consequently the premium for tenant's insurance policy will go up.

In order to relief such claim from the landlord's insurer, the tenant should require the landlord to include in its insurance policy a Waiver of Subrogation (a proper clause should be inserted in the lease) respecting the tenant. With such a waiver, the landlord's insurer cannot hold the tenant liable after the landlord has made the claim and accordingly the tenant's insurance premium will not be affected.