

Structuring Lease Agreements To Maximize Subrogation Recoveries

One of the most frustrating scenarios in the subrogation world is when a promising claim with clear liability on the part of a tenant is barred or limited based on lease language. When it comes to lease agreements, a potential future subrogation claim against a tenant is usually an afterthought. However, there are a few simple provisions that a landlord or property management company can proactively add to a lease agreement that will significantly improve the opportunities for a subrogation recovery if there is loss at an insured property.

Successful subrogation recoveries can have significant benefits to landlords as they can favorably impact loss ratios and future insurance premiums. In addition, if an insurance carrier is aggressively pursuing a subrogation claim, it can help a landlord recover some or all of its deductible.

A common legal obstacle to pursuing subrogation claims against a tenant is the “implied coinsured rule” or “Sutton rule.” This is a judicially created doctrine that precludes a landlord’s insurance carrier from subrogating against the landlord’s tenant. This doctrine has been adopted in one form or another by courts in numerous states throughout the country based on various public policy considerations. Some jurisdictions have adopted a default rule that a residential tenant cannot be liable on a subrogation claim by the landlord’s carrier unless the lease expressly permits such a claim. Other jurisdictions have adopted a case-by-case approach where the court looks at the language of the lease and tries to interpret the intent of the parties with regard to subrogation claims against a tenant. Regardless of the nuances of the jurisdiction where an insured property is located, a landlord can remove any possibility of the implied coinsured rule applying by simply including language in the lease that expressly allows for subrogation claims against a tenant. This language can be coupled with provisions that make tenants responsible for any damages caused by either the tenants or their houseguests and a requirement that the tenants maintain liability insurance coverage.

Another common obstacle to pursuing subrogation claims against a responsible tenant is a mutual waiver of subrogation provision in the lease. Under a mutual waiver of subrogation, both the landlord and tenant agree to waive claims against one another to the extent the loss is covered by insurance. Waivers of subrogation are widely enforced by courts and are generally reviewed as risk allocation rather than exculpatory provisions. While mutual waivers of subrogation are fairly common in leases, there is no requirement that a waiver of subrogation be mutual in order for it to be enforceable. In addition, a tenant is more likely to benefit from a mutual waiver of subrogation than a landlord, particularly in the context of residential leases. An alternative to a mutual waiver of subrogation is to include only a unilateral waiver of subrogation whereby a tenant waives subrogation claims against a landlord, but the landlord does not waive subrogation claims against the tenant.

Another challenge to pursuing subrogation claims against tenants can be the lack of or limited liability insurance coverage. It is always a good practice to require tenants to maintain a renters policy with liability insurance coverage. However, residential leases that require tenants to maintain liability insurance often only require \$100,000 in liability coverage, which may not go very far on a significant loss, particularly if there are other tenants who sustain damage and are pursuing claims against the responsible tenant. With most renters’ policies, the cost of increasing the liability coverage from \$100,000 to \$300,000 is fairly nominal. There is no downside to landlords requiring tenants to maintain a higher level of liability insurance coverage.

The above-suggested lease provisions can significantly improve the likelihood of a subrogation recovery if there is a loss. Structuring leases to maximize subrogation opportunities can have



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significant benefits to a landlord and is a relatively easy thing to do without any cost to the landlord.
