

Recent State Supreme Court Decision Has Significant Implications for Indemnity and Insurance Clauses in Commercial Leases

Karen O'Malley*

Erin E. Morrissey**

Goulston & Storrs, P.C.

Boston, MA

Introduction

Indemnity and insurance provisions are key components of commercial leases. However, due to a number of open legal issues related to the enforceability of these types of provisions, Massachusetts practitioners have faced the challenge of adequately protecting their clients' interests while lacking clarity as to whether certain lease provisions would in fact be deemed enforceable by state courts.

This article examines the Massachusetts Supreme Judicial Court's recent decision in *Norfolk & Dedham Mutual Fire Ins. Co. v. Morrison et al.*,¹ which resolved several open questions related to indemnity and insurance clauses in commercial leases. In particular, the court clarified that Mass. G.L. c. 186 § 15 applies to commercial leases and residential leases alike, and held that under Mass. G.L. c. 186 § 15, the parties to a commercial lease cannot contract away any amount of liability for a landlord's negligent acts. The court also distinguished between obligations to indemnify and obligations to purchase liability insurance, thereby validating commercial lease provisions requiring that the landlord be named as an additional insured under the tenant's insurance policy.

In addition to reviewing the substance of the court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.*, as well as its significance with respect to commercial lease provisions, this article identifies those issues that remain unresolved following the court's decision and provides practical tips for navigating these lingering uncertainties.

Massachusetts General Laws c. 186 § 15

Massachusetts General Laws c. 186 § 15 voids lease provisions that require tenants to indemnify landlords or release them from liability for their own negligence. Specifically, § 15 provides that:

[a]ny provision of a lease or other rental agreement relating to real property whereby a lessee or tenant enters into a covenant, agreement or contract, by the use of any words whatsoever, the effect of which is to indemnify the lessor or landlord or hold the lessor or landlord harmless, or preclude or exonerate the lessor or landlord from any or all liability to the lessee or tenant, or to any other person, for any injury, loss, damage or liability arising from any omission, fault, negligence or other misconduct of the lessor or landlord on or about the leased or rented premises or on or about any elevators, stairways, hallways or other appurtenance used in connection therewith, shall be deemed to be against public policy and void.

Shopping Center Legal Update is published by the Legal Department of the International Council of Shopping Centers, Inc., 1221 Avenue of the Americas, 41st floor, New York, NY 10020-1099; *William Taubman*, Chairman; *Michael P. Kercheval*, President & CEO; *Gregory Peterson*, General Counsel.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is distributed with the understanding that the publisher is not engaged in rendering legal, accounting or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

Editor-in-Chief: Stephanie McEvily, Esq.

Spring Issue Editors: Thomas Barbuti, Whiteford, Taylor & Preston LLP, Baltimore, MD, www.wtplaw.com; Mitchell Block, Selman, Munson & Lerner, Austin, TX, www.selmanmunson.com; Lara E. Rycyk, DJM Realty Services, Melville, NY, www.djmarealty.com; Mindy Sherman, Perkins Coie, Chicago, IL, www.perkinscoie.com; Joshua Stein, Joshua Stein PLLC, 59 East 54th Street, New York, NY, joshua@joshuastein.com, www.joshuastein.com; Natalie Vukovich, Daoust Vukovich LLP, Toronto, Ontario, Canada, www.dv-law.com; Daniel K. Wright, Taft, Stettinius & Hollister, Cleveland, OH, www.taftlaw.com

Summer Issue Editors: Elizabeth H. Belkin, Belkin Law Offices, Chicago, IL, ehbelkin@belkinlawoffices.com; Fredric L. Carsley, De Grandpré Chait LLP, Montreal, Canada, www.dgclaw.com; Kevin Groarke, Sonnenschein, Nath & Rosenthal, New York, NY, www.sonnenschein.com; Brian D. Huben, Katten Muchin Rosenman, Los Angeles, CA, www.kattenlaw.com; George J. Krocilick, Duane Morris LLP, Philadelphia, PA, www.duanemorris.com; John Lewis, Seyfarth & Shaw, Boston, MA, www.seyfarth.com; Eric Rapkin, Akerman Senterfitt, Ft. Lauderdale, FL, www.akerman.com

Fall/Winter Issue Editors: J. Yost Conner, Jr., Patton Boggs LLP, Washington, DC, www.pattonboggs.com; Tami Daniel, Whiteford, Taylor & Preston LLP, Baltimore, MD, www.wtplaw.com; Gary Kessler, Kessler Collins, Dallas, TX, www.kesslercollins.com; Karen O'Malley, Goulston & Storrs, Boston, MA, www.goulstonstorrs.com; Blair A. Rebane, Borden Ladner Gervais LLP, Vancouver, Canada, www.blgcanada.com; Matthew P. Seeberger, Cox, Castle & Nicholson, Los Angeles, CA, www.coxcastle.com

The purpose of § 15 is to prevent a landlord from shifting responsibility for its own negligence to its tenants. The statute does not specify whether or not it applies to both commercial and residential leases. However, Massachusetts practitioners have long assumed that the statute applied to commercial leases and residential leases alike. The supreme judicial court in *Norfolk & Dedham Mutual Fire Ins. Co.* held that this is in fact the case, noting that there was "nothing in the words of the statute or its context that would suggest that its reach was intended to be less than all leases relating to real property."

Norfolk & Dedham Mutual Fire Ins. Co. v. Ellen Morrison et al.

The landlord in *Norfolk & Dedham Mutual Fire Ins. Co.* owned an office park and leased a portion of the property to a medical office. During the term of the lease, a patient visiting the medical office injured herself on a newly constructed cement curb in the parking lot of the office complex. The patient subsequently sued both the tenant (the owner of the medical office) and the landlord, alleging negligence. Following the commencement of that action, the landlord demanded that the tenant and the tenant's insurer, Norfolk & Dedham Mutual Fire Insurance Company, indemnify the landlord in accordance with certain provisions of the lease, as the landlord was named as an additional insured under the tenant's policy. The tenant's insurer sought a declaratory judgment in superior court that the liability and insurance provisions of the lease were void under Mass. G.L. c. 186 § 15. Accordingly, the tenant's insurer argued that it did not have a duty to defend or indemnify the landlord.

The lease contained the following liability provision:

LIABILITY. LESSEE shall be solely responsible as between LESSOR and LESSEE for deaths or personal injuries to all persons and damage to any property, ... occurring in or on the leased premises (including any common areas as described below) and arising out of the use, control, condition or occupancy of the leased premises by LESSEE, except for death, personal injuries or property damage directly resulting from the sole negligence of LESSOR. LESSEE agrees to indemnify and hold harmless LESSOR and OWNER ... from any and all liability, including but not limited to costs, expenses, damages, causes of action, claims, judgments and attorney's fees caused by or in any way arising out of any of the aforesaid matters, except for death, personal injuries or property damage directly resulting from the negligence of LESSOR. All common areas, including but not limited to any parking areas, stairs, corridors, roofs, walkways and elevators ... shall be considered a part of the leased premises for liability and insurance purposes when they are used by LESSEE or LESSEE's employees, agents, callers or invitees.

The insurance clause contained in the lease provided as follows:

INSURANCE. LESSEE shall secure and carry at its own expense a commercial general liability policy insuring LESSEE, LESSOR and OWNER against any claims based on bodily injury (including death) or property damage arising out of the condition of the leased premises (including any common areas as described above) or their use by LESSEE, including damage by fire or other casualty, such policy to insure LESSEE, LESSOR and OWNER against any claim up to \$1,000,000 for each occurrence involving bodily injury (including death), and \$1,000,000 for each occurrence involving damage to property. This insurance shall be primary to and not contributory with any insurance carried by LESSOR, whose insurance shall be considered excess. LESSOR and OWNER shall be included in each such policy as additional insureds ... and each such policy shall be written by or with a company or companies satisfactory to LESSOR.

In granting summary judgment to the tenant's insurer, the lower court judge did not rule on the validity of the liability provision, finding that it did not effectively shift liability to the tenant for injuries resulting from the "sole" negligence of the landlord in the manner prohibited under § 15. Specifically, the judge concluded that because the injury occurred in a common area for which the landlord was responsible, the injury, if it was in fact the result of negligence, could only have been attributable to the landlord's sole negligence.

In addition, the lower court judge ruled that the insurance provision of the lease was void under § 15, because naming the landlord as an additional insured under the tenant's insurance policy amounted to the type of indemnification prohibited by the statute. This holding left many commercial landlords in a precarious position, as it called into question the widespread practice of requiring that the landlord be named an additional insured under the tenant's liability insurance policy.

As noted above, the supreme judicial court ruled on appeal that § 15 does, in fact, apply to commercial leases as well as residential leases. With respect to the liability provision of the lease, the court upheld the second clause of the provision. That is, the tenant would indemnify the landlord and hold the landlord harmless from liability for injuries and property damage arising out of the use or condition of the premises *except* for injuries resulting directly from the landlord's negligence. The court found that this second provision was consistent with § 15 because it did not release the landlord from liability for injuries caused by the landlord's negligence.

The court then turned to the first clause of the liability provision, which had been the focus of the lower court judge's review. This clause provided that the tenant would be solely responsible for injuries and damage occurring on the leased premises, *except* for those resulting from the "sole negligence" of the landlord. The court found that the language would effectively shift to the tenant responsibility for injuries and damage arising from negligent acts for which the landlord may be partially, but

not solely, responsible. Consequently, the court concluded that the clause was void as violative of § 15. The effect of this holding is that under § 15, the parties to a commercial lease cannot contract away any amount of liability for a landlord's negligent acts.

Additionally, the court disagreed with the lower court's ruling that the insurance provision amounted to the type of indemnification barred by the statute, concluding instead that indemnity provisions impose "obligations that are separate and distinct from the obligations imposed by an insurance provision." The court reasoned that § 15 does not apply to insurance provisions because the duty of indemnification resides not with the tenant, but rather with the insurer. In support of its conclusion, the court cited a federal district court decision interpreting Massachusetts law [*Great N. Ins. Co. v. Paimo Assocs.*, 364 F.Supp.2d 7(D. Mass. 2005)], which distinguished an obligation to purchase liability insurance from an obligation to indemnify in a dispute involving a commercial lease and the provisions of § 15, as well as a number of cases from other jurisdictions that have recognized this distinction. This holding validates lease provisions requiring that the landlord be named as an additional insured under the tenant's insurance policy.

Nevertheless, while the court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.* resolved a number of open questions with respect to indemnity and insurance clauses in commercial leases, it also raised new questions with which commercial landlords and tenants must now grapple.

Remaining Open Issues—Waivers of Subrogation and Tenants Who Opt to Self-Insure

The most significant open issue after *Norfolk & Dedham Mutual Fire Ins. Co.* concerns the relationship between waivers of subrogation and tenants who self-insure. In order to demonstrate the ambiguity that remains, each of these issues will be addressed in turn below.

Simply stated, the right of subrogation is the right to pursue another party's claim as if it were your own. As many readers are aware, it is quite common in commercial leases for the parties to waive subrogation rights. Waivers of subrogation typically state that the parties each waive rights of recovery against the other to the extent that the loss is covered by insurance, and that the parties agree to obtain insurance policies in which a party's insurance company waives any rights of subrogation that it may have against the other party, even if the other party were at fault.

The reason for including a waiver of subrogation in a lease is illustrated by the following example: Suppose that a building built by the tenant is damaged in a fire caused by the landlord's negligence. Without a waiver of subrogation, and assuming that the tenant is carrying fire insurance, the insurance company could pay the tenant for the value of the damaged portion of the building and then bring an action against the landlord to recover the amount it paid to the tenant. In most cases, such a result is contrary to the parties' intent, as the parties typically intend that both parties benefit from the protection of the insurance policy. A waiver of subrogation will ensure that both parties are protected when damages occur. Under *Norfolk & Dedham Mutual Fire Ins. Co.*, a waiver of subrogation, on its own, is still valid, since a third-party insurer, not the tenant, would be the party releasing the landlord from liability.

Just as it is common for commercial leases to include waivers of subrogation, it is not uncommon for commercial leases to provide that tenants may self-insure. This option is appropriate for sophisticated tenants with sufficient resources to give landlords comfort that they will be able to cover any damages that may arise during the term of the lease and that would otherwise be covered by an insurance policy. It is typical to require that a party satisfy certain creditworthiness tests in order to qualify for self-insurance. In almost all cases, even if full self-insurance is not permitted, some form of self-insurance exists because of the presence of insurance deductibles and coinsurance arrangements, which require that the insured pay for a portion of any losses. While self-insurance more typically involves casualty issues, it is not uncommon in liability issues, as well, where some insureds maintain huge deductibles (sometimes called self-retention). Self-insuring is advantageous for tenants because it can represent significant savings as compared to the cost of procuring and maintaining insurance through a third-party insurer.

Where a lease includes a waiver of subrogation and also provides that the tenant may self-insure, the landlord is no longer released from liability by a third-party insurer, which would be valid under *Norfolk & Dedham Mutual Fire Ins. Co.*, but is instead released from liability by the tenant. As discussed above, after *Norfolk & Dedham Mutual Fire Ins. Co.*, lease provisions in which the tenant agrees to release the landlord from liability arising from the landlord's sole, or even partial, negligence are void under §15. Thus, it is unclear whether waivers of subrogation will still be enforceable in cases where tenants have opted to self-insure.

Practical Tips/Suggested Language

After *Norfolk & Dedham Mutual Fire Ins. Co.*, parties that wish to include both a waiver of subrogation and a provision stating that the tenant may self-insure run the risk that a court could deem the waiver of subrogation provisions unenforceable, even if the tenant does not elect to self-insure. In such a scenario, the landlord would be left without the benefit of the waiver, even if the tenant did not self-insure. However, if a landlord is willing to take this risk, it should be sure to include carefully drafted language in the insurance section of its lease, so that it is protected to the maximum extent possible.

Suggested language in this instance is as follows:

During all periods in which the Tenant shall be permitted to self-insure its merchandise and leasehold improvements in the demised premises, the rights and obligations of the Landlord and the Tenant shall remain the same as if the Tenant shall have purchased and

kept in force thereon insurance from an independent, institutional insurer of recognized responsibility, and, without limitation, the provisions of Sections ____ [Landlord has no liability for Tenant's Fixtures Furniture & Equipment] and ____ [waiver of subrogation] of this lease shall remain in full force and applicable. Without limitation of the foregoing, it is specifically agreed that if Tenant so self-insures in accordance with the foregoing, and with respect to any and all payments made by Tenant (i) to satisfy any applicable insurance deductible and (ii) pursuant to any coinsurance arrangements, Tenant shall, for purposes of Mass. G.L. c. 186 § 15, be deemed to be the insurer of any loss which is suffered by Tenant as the result of so self-insuring, and Tenant hereby expressly waives any claims it may have against Landlord for losses in excess of such self-insurance even if such damage arises from the negligent acts or omissions of Landlord, or Landlord's agents or employees; provided, however, that Tenant shall not be required to pay "proceeds" to any person or entity as the result of being deemed the insurer of any such loss. The foregoing provisions (as well as any other provisions dealing with indemnity and the like by Tenant of Landlord) shall be deemed to be modified in each case by the insertion in the appropriate place of the language: "except as otherwise provided in Mass. G.L. c. 186 § 15".

The last saving clause is most critical to try to protect the enforceability of the release of liability when the tenant insures with a third-party insurance company.

Conclusion

The court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.* provided much-needed guidance with respect to the enforceability of indemnification and insurance provisions in commercial leases, clarifying that: (i) Mass. G.L. c. 186 § 15 applies to commercial leases; (ii) § 15 should be strictly interpreted to preclude landlords from shifting any responsibility for their own negligence to tenants; and (iii) lease provisions requiring that the tenant name the landlord as an additional insured under the tenant's insurance policy are valid.

The issue remains whether a tenant who self-insures will be able to assert a claim against the landlord for damages arising out of the landlord's negligence because of its status as a tenant and the impact of Mass. G.L. c. 186 § 15 or whether the tenant can waive that claim by placing itself in the status of an insurer. The careful draftsman will seek to put the issue in its best light, but also will draft so that the nullifying effect of Mass. G.L. c. 186 § 15 is limited.

*KAREN O'MALLEY is a Director in Goulston & Storrs' Real Estate group. She has real estate experience in the acquisition, permitting, financing and leasing of all types of commercial properties. She focuses her practice on retail and office leasing, representing landlords who lease to national and regional tenants in enclosed mall, lifestyle and transportation-centered projects. She also represents landlords and tenants in a variety of office buildings, including corporate headquarters and mixed-use developments.

**ERIN E. MORRISSEY is an Associate in Goulston & Storrs' Real Estate group and focuses her practice on general real estate matters. She is a LEED Accredited Professional.

¹*Norfolk & Dedham Mutual Fire Insurance Co. v. Morrison*, N.E.2d, 2010 WL 1345156 (Mass. April 8, 2010).