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When Is A Tenant Who Causes Fire Damage To Property A Co-Insured Under The Landlord's Policy?

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The doctrine of subrogation allows an insurance company, that has paid its insured's claim, to recoup the sums paid pursuant to the provisions of its policy from the entity, or person, that caused the loss that formed the basis of the insurance claim. For obvious reasons, an insurer cannot use subrogation to recover losses from its own insured because it would defeat the very purpose of an insurance policy, namely, the protection of its insured from the financial consequences of an unforeseen loss. Consequently, when a tenant negligently causes a loss to his/her landlord's property it is not unusual for the tenant to attempt to by-pass liability by claiming that he/she is a co-insured under the landlord's policy. This raises the question: when is a tenant an insured under the landlord's policy? This article will explore how the California courts handle the matter by focusing on two cases: one that was decided in favor of the subrogating insurance company and the other, of the tenant, thereby abrogating the right of subrogation.

In California, it has been long established that one is liable for one's negligent conduct. (Civil Code section 1714(a)) For decades, this concept has applied to tenants. For example, in *Morris v Warner* (1929) 207 Cal. 498, the California Supreme Court noted:

> Neither the rebuilding clause nor the provisions of the lease to the effect that the lessee should keep said premises in good repair and condition at his own expense, *damage by fire or elements excepted*, and at the end of the term quit and surrender said premises to the lessor in good repair, *damage by fire* and ordinary use excepted, can reasonably be construed as relieving the lessee from liability to the lessor for a fire caused by his own negligence or as requiring the lessor to rebuild in the event that the premises should be destroyed by a fire thus caused by the negligence of the lessee. (*Id.* at p. 501-502) (Emphasis in the original)

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When a tenant claims to be a co-insured under the landlord's policy, the key test applied in California can be summarized as follows: given the terms of the lease agreement, did the tenant (prior to the incidence of loss) have a reasonable expectation that he/she was covered by the landlord's insurance policy? Put another way, did the parties to the lease agreement intend that the tenant be a co-insured? The following cases give an overview of how California courts have approached the issue.

In *Parsons Manufacturing Corporation, Inc. v Superior Court of San Mateo County (1984)* 156 Cal.App. 3d 1151, the facts are as follows:

> An insurer that had paid its insured, a lessor of commercial premises, for fire damage to the premises brought an action against the lessee alleging that the lessee's negligence had

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caused the fire and that the insurer was subrogated to the lessor's rights under the lease agreement. The lessee entered a general denial to the complaint and asserted the affirmative defense that in the lease the lessors had waived subrogation for damage by fire. The insurer moved for partial summary judgment, seeking a determination that the lessors had not waived subrogation. (*Id.* at p. 1151 Summary)

In *Parsons,*

> The Court of Appeal ... directed the trial court to ... enter a new order granting summary judgment in favor of the lessee. It held that the lease agreement alone was a sufficient showing in support of the lessee's motion for summary judgment, because it was rife with hints that the lessor would procure insurance on the premises, and the lessee was entitled to expect that such insurance would be for its benefit as well as the lessor's. In addition, the lessee showed that the lessor had selected the lease form and lessor did not understand it as requiring the lessee. to maintain fire insurance. (*Id.* at p. 1151 - Summary)

The *Parsons* court ruled that, "The issue raised is whether the lessor's insurer is barred from suing lessee for a negligently caused fire ... We conclude that ... lease provisions bar recovery by the insurer." (*Id.* at p.1155) "The vital question, therefore, is whether the provision in question, which requires the lessor to maintain fire insurance to cover the value of the buildings, is a provision made for the benefit of the lessee as well as the lessor." (*Id.* at p. 1159)

> We do not mean our opinion to state that a lessor may never shift to the lessee the burden of insuring against the lessee's negligence. We state only that, at least where the agreement adverts to the possibility of fire and there is no clear language or other admissible evidence showing an agreement to the contrary, a lease agreement should be read to place on the lessor the burden of insuring the premises (as distinguished from the lessee's personal property) against lessor *and lessee* negligence. Moreover, where the lease has been drawn by the lessor, its language will be construed strictly against the lessor and its insurer. (*Id.* at p. 1162) (Emphasis in the original)

The *Parsons* court's interpretation of the provisions of the written lease agreement led to the conclusion that the insurer was barred from recovering under the doctrine of subrogation. The court believed that the lease agreement showed an intent that the tenant benefit from the fire policy, thereby making the tenant a co-insured.

The *Parsons* court made a point of stating that the lease was prepared by the landlord ("Moreover, where the lease has been drawn by the lessor, its language will be construed strictly against the lessor and its insurer.") (*Id.* at p. 1162). This fact allowed the court to apply the contra preferentem rule, which holds that where a document is ambiguous, or deficient, the ambiguity/deficiency should be construed against the party that prepared the document and in favor of the other party that did not. In *Parsons*, the court found that the lease agreement "was rife with hints that the lessor would procure insurance on the premises." Therefore, the tenant had a reasonable expectation of coverage under the landlord's policy and the burden was on the landlord to clarify the matter because he prepared the agreement.

It is important to note that *Parsons* does not create a blanket right in favor of tenants. The court was quick to point this out by stating: "We do not mean our opinion to state that a lessor may never shift to the lessee the burden of insuring against the lessee's negligence." (*Id.* at p. 1162)

In *Fire Ins. Exchange v Hammond* (2000) 83 Cal.App. 4th 313, "an action by a fire insurer against the lessees of its insured, for subrogation for payment to the insured for fire damage to the premises alleged to be caused by defendants' negligence, the trial court granted summary judgment for defendants." (Id at p. 313 - Summary)

The Hammond court, after reviewing several California and non-California authorities, ruled: "We reverse the judgment, concluding the rental agreement here expresses no intent of the parties to insure the Hammonds under the lessor's policy or to exculpate them from negligence liability." (Id at p. 315)

"In California, courts have held a lessee is not responsible for negligently caused fire damages where the lessor and lessee intended the lessor's fire policy to be for their mutual benefit." (Id at p. 317)

"In *Fred A. Chapin Lumber Co. v. Lumber Bargains, Inc.*, the court inferred the lessor's policy was for the mutual benefit of the lessor and lessee where the lease expressly required the lessor to maintain fire insurance." (Id at p. 317)

> In *Liberty Mutual Fire Ins. Co. v. Auto Spring Supply Co.*, the lessee's

insurer was denied subrogation against the sublessee. Under the lease agreements, the sublessee's rent covered the premium on the lessee's fire policy and proceeds of the policy were to be used to repair fire damages. The court held it was 'quite obvious ... the parties to the lease and the sublease all intended that the proceeds of Liberty's fire insurance policy, maintained by the lessee at [the sublessee's] expense, were to constitute the protection of all parties to the lease documents against the fire loss[.] This was the commercial expectation of these parties. Stated otherwise, under the facts of this case, we regard the subtenant ... as an implied in law co-insured of [the lessee], absent an express agreement between them to the contrary.' (Id at p. 317-318)

The *Hammond* court noted that, "In *Rizzuto*, as in *Parsons*, the lease contained a yield-up clause excepting fire damages. Further, the lessors and lessee discussed the possibility of fire and that the lessors insured against such peril." The court held, "If the lessors did not expect to cover the lessee under their policy, they should have expressly notified the lessee of the need for a second policy to cover its interest. Since they failed to do so, they have no cause of action against the lessee for the fire damage, and the insurance company has no right of subrogation." (*Id.* at p. 319)

The *Hammond* court noted that:

In contrast to the yield-up clause in *Parsons* excepting fire loss, the yield-up clause here excepts only normal wear and tear.' A yield-up clause excepting fire damage may support the implication the lessee reasonably expected coverage under the lessor's policy ... unlike in *Parsons*, the agreement here expressly holds the Hammonds liable for damages caused by their negligence or the negligence of their guests or invitees. Notably, the yield-up and negligence provisions appear together, stressing the Hammonds' liability for the negligent failure to surrender the premises in good condition. (*Id.* at p. 320)

The *Hammond* court ruled:

Under the rental agreement here, we conclude the parties had no reasonable expectation the Hammonds were exculpated from liability for negligently caused fire damages or that Dawson's FIE policy was for their mutual benefit. The agreement contains no term expressly or impliedly overriding the provision holding the Hammonds liable for their negligence or the negligence of their guests or invitees, whatever the cause. Accordingly, FIE's subrogation action is viable and the Hammonds are not entitled to judgment as a matter of law. (*Id.* at p. 321)

In California, whenever a written agreement governs a relationship, the court looks at the terms of the agreement and interprets them according to

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established rules of contract interpretation ("A contract must be interpreted to give effect to the mutual, expressed intention of the parties. Where the parties have reduced their agreement to writing, their mutual intention is to be determined, whenever possible, from the language of the writing alone." *Hammond* at p. 321 citing caselaw.) It is, therefore, not surprising that, in cases such as *Hammond* and *Parsons*, the key to the court's approach was to determine the intention of the parties from the terms of the lease agreement.

The lease provisions in the two cases of *Hammond* and *Parsons* show two different intentions of the parties to the agreement. In one case, the parties intended that the tenant be a co-insured under the landlord's policy (*Parsons*), while the lease terms in the other case showed an opposite intent (*Hammond*).

In the 2008 case of *Praetorian Financial Insurance Co. v United States of America* 2008 U.S. Dist. LEXIS 53599, the facts were:

> Plaintiff Praetorian Financial Insurance Co. (the "Carrier") insured a landlord ... who leased property to defendants-tenants the United States of America and the United States Postal Service (the "Tenants"). The property suffered extensive damage allegedly due to a fire set negligently or intentionally by the Tenants' agents. In this action ... the Tenants request this Court to dismiss this action ... on the grounds that under the terms of their lease, the Landlord obtained fire insurance for the mutual benefit of *both* the Landlord and the Tenants, thus preventing the Carrier from subrogating through the Landlord against the Tenants.

The U.S. District Court applying California law to the facts before it (after reviewing various cases) ruled that:

> The Carrier urges the Court to follow *Morris v. Warner* ... while the Tenants urge the Court to follow *Parsons* ... As discussed below, the Court follows *Parsons*, and *Fire Insurance Exchange v. Hammond* ... ("FIE"), the most recent decision in this area of California law. As the *FIE* court held, 'In California, courts have held a lessee is not responsible for negligently caused fire damages where the lessor and lessee intended the lessor's fire policy to be for their mutual benefit.' ... In this case, as discussed below, taking the Carrier's complaint and the Lease at face value, there is insufficient evidence for the Court to find the Tenants and the Landlord intended the Landlord to procure fire insurance for their mutual benefit. As such, the Court holds the Carrier may subrogate against the Tenants. (LEXIS cite at p. 9)