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New Insurance Case: Owners' Insurance Barred in Reimbursement Action Against Tenant – **Lesson:** Properly Specifying Insureds Can Avoid Costly Disputes and Litigation

By Jason M. Adams, Esq.

The *Western Heritage Ins. Co. v. Frances Todd, Inc.* (2019 Cal.App. LEXIS 299 / 2019 WL 1450731) case has potential implications for insurance carriers, policyholders, condominium associations, unit owners, landlords and tenants.

The case involves a fire at a commercial condominium complex (the "Association"). The Association's CC&Rs required the Association to purchase a master fire insurance policy for the benefit of the Association and owners, with a waiver of subrogation endorsement that stated the insurance company could not seek reimbursement from the Association, its officers, owners or occupants of the units in the event of a covered fire. The CC&Rs also prohibited individual owners from obtaining their own fire insurance. The Association purchased the required fire insurance policy from Western Heritage Insurance Company ("Western Heritage").

One of the owner's tenants, Frances Todd, Inc. ("Frances Todd"), allegedly caused a fire that damaged several units. Although the unit owner was covered as an additional named insured under the Western Heritage fire policy, the tenant, Frances Todd, was not. Western Heritage paid for the common area fire damage caused by Francis Todd, and then sued Frances Todd in a subrogation action to recover the amounts paid.

Frances Todd filed a motion for summary judgement asking the court to dismiss Western Heritage's case. Frances Todd argued that it was reasonable for Francis Todd to expect to be covered by the unit owner landlord and/or Association's fire insurance policies. Frances Todd based its reliance on the terms of the lease agreement with the owner and the Association's CC&Rs, which expressly and/or impliedly stated that the landlord and/or Association would obtain the fire policy. Frances Todd further argued that Frances Todd should be covered as an "implied co-insured" under the Association's policy. Frances Todd concluded that if Frances Todd was an implied co-insured under the policy, then Western Heritage was unable to bring a subrogation action against them pursuant to the waiver of subrogation and requirements set forth in the CC&Rs.

Western Heritage countered by arguing that Frances Todd was not insured under the policy because Frances Todd had no contractual relationship with the Association, nor was Frances Todd a named insured under the policy. Western Heritage also contended that Frances Todd was not an implied insured because the language of the lease between Frances Todd and the owner did not require the owner landlord to procure fire coverage.

The Court disagreed with Western Heritage and found that Frances Todd was an implied insured under the policy. The Court noted the rule in California that precludes a subrogation action by a fire insurance company of a lessor against a lessee where a lessee's negligence causes a fire, but the policy is intended to benefit a lessee. The Court determined that the fire insurance policy was maintained for the benefit of Frances Todd and therefore Western Heritage could not seek subrogation from Frances Todd.

What the case means for policyholders and insurance carriers:

This case demonstrates the importance of making sure that the language of insurance policies conforms to the contractual requirements of the parties. It is prudent to have an experienced risk manager and legal counsel review the contractual requirements of the parties to make sure that adequate coverage is obtained so as to avoid costly legal disputes.

The *Western Heritage* case is beneficial to policyholders because it limits a fire insurance company's right to seek reimbursement from at-fault tenants in certain circumstances. Insurance coverage is more attractive to insureds when the insured does not have to worry about an insurance company paying a claim and subsequently suing the insured's tenant for reimbursement.

Conversely, the *Western Heritage* case is potentially problematic for insurance carriers depending on a court's willingness to adopt the concept of "implied insureds." Tenants who even potentially benefit from a policy will undoubtedly use the Western Heritage case to argue that they are "implied insureds" who are immune from subrogation actions from landlord or association carriers. Resolution of this issue will likely depend on how broadly or narrowly a court interprets the *Western Heritage* decision based on the facts of each particular case. In any event, the decision may cause fire carriers to pull back on their willingness to provide waiver of subrogation endorsements and/or result in increased premiums to account for potential tenant losses.

What the case means for condominium associations:

Associations need to be cognizant of the fact that unit owners and their tenants will likely look to the association to provide fire insurance coverage absent clear language to the contrary in the association's CC&Rs. The association should also note that its fire insurance carrier may not be able to seek reimbursement from a unit owner's tenant if the tenant causes a fire. This could make fire cases more difficult to resolve.

Associations should review their CC&Rs and insurance policies to ensure that the provisions pertaining to these issues clearly achieve the Association's desired intent.

What the case means for unit owners acting as landlords and their tenants:

Similar to the above, unit owners acting as landlords should note that their tenants may be looking to the owner and/or association to procure fire insurance absent clear language to the contrary in the association's CC&Rs and/or lease agreement.

Landlords and tenants should review their leases and confirm that the lease clearly defines which party has the burden of procuring what types of insurance. In the *Western Heritage* case, the court noted that a lease agreement should be read to place the burden on the lessor to insure the premises against lessor and lessee negligence. Thus, the burden was on the landlord to procure fire insurance for the benefit of both lessor and lessee. Therefore, the tenant was covered under the Association's master policy, which was intended to cover the owner. Had the language of the lease been different, the tenant may have been left facing a subrogation action.

Unit owners may consider requiring tenants to maintain (a) their own contents coverage and (b) a rental (tenants) dwelling policy with general liability coverage that will cover both the tenant and landlord. The renter likely cannot obtain a policy for damage to the structure/common area because the renter is in possession, not ownership, and probably has no insurable interest in the structure.

Careful drafting of the applicable lease provisions at the outset can serve to clarify the ambiguities that were present in the *Western Heritage* case and prevent issues down the road.

Conclusion:

The *Western Heritage* case highlights the interconnectivity of insurance coverage and the impact of one policy on several different parties (association, owners, landlords, and tenants), agreements (CC&Rs and lease agreements) and areas of law (insurance, common interest development, and landlord/tenant).

Again, it is critical that all parties involved consult legal and insurance professionals who are familiar with both the relevant areas of insurance and corresponding areas of law in order to

ensure policies, governing documents and/or lease agreements work together to achieve the desired outcomes. If not, the parties risk leaving the nature and extent of their exposure to the courts to decide after costly protracted litigation.

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