SELF-INSURANCE---RISK ANALYSIS
AND
HOW DOES IT WORK?

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I. General Provisions.

A. This Article will apply to the landlord and tenant relationship only. These materials do not deal with insurance in connection with construction or development, residential insurance for single family or multi-family dwellings or surety bonds.

B. Under common law, neither the landlord nor the tenant was obligated to repair damage caused by casualty and the tenant would remain liable for the rent payments, unless the lease provided otherwise. Crow Lumber & Bldg. Materials Co. v. Washington Cty. Library Board, 428 S.W.2d 758 (Mo. App. 1968) (collecting cases which maintain tenant obligation to pay rent notwithstanding casualty loss); Morris v. Durham, 443 S.W.2d 642 (Ky. App. 1969). However, if the damage was caused by the negligence of a party, then, except as the lease might otherwise provide, that negligent party might be liable to repair the damages. National Motels, Inc. v. Howard Johnson Inc. of Washington, 373 F.2d 375 (4th Cir. 1967); Mabrey v. McNeil, 534 A.2d 1256 (Conn. App. 1987).

C. A landlord and a tenant each has its own insurable interests and, unless provided otherwise, neither one has a right to claim an interest in insurance proceeds received from the separate property of the other. However, a lease may provide various arrangements for insurance.

   1. Each party can be required to insure its own interests and each may recover from its own interests. A tenant’s interest is the value of its improvements and betterments for the unexpired term of the lease. A tenant may obtain improvements and betterments insurance.

   2. Either the landlord or the tenant may be required to obtain insurance for the interest of both parties and, in such case, each party would also be entitled to recover for loss or damage to its own respective interests, the landlord for the building and the tenant for the value of its improvements and betterments for the unexpired term, unless otherwise provided.

   3. Suppose a tenant is required to restore damage to the premises and is only entitled to reimbursement from the landlord’s insurance and not from the landlord. Loving v. Ponderosa Systems, Inc., 479 N.E.2d 531 (Ind. 1985). If the mortgagee takes the proceeds to satisfy the mortgage, then the tenant should be subrogated to the rights of the mortgagee under the mortgage to recover from the landlord so much as the tenant may have paid for restoration, up to the amount of insurance.

   4. What if a landlord or a tenant fails to supply insurance required under the terms of the lease and a loss occurs? Would the party that failed to provide the insurance be liable for the amount of the loss up to the amount of insurance agreed to be obtained? Stefani v. Capital Tire, Inc., 425 N.W.2d 500 (Mich. App. 1988). That would be the normal measure of damages unless the other party knew or should have known that there
was no insurance obtained by the party required to do so and then liability would be limited to the cost of premiums since the other party could have mitigated damages by obtaining the insurance. Rodriguez v. Nachamie, 395 N.Y.S.2d 51 (App. Div. 1977).

D. Self-Insurance may affect casualty insurance and liability insurance and the deductible portion of both, rental insurance and uninsured events.

1. An insurance policy where the insurance company does not pay for loss until the loss is in excess of a certain amount is called a policy with a “deductible”. Since the amount that might be necessary to settle a claim that might arise in the future is unknown, the parties are always concerned about the amount of coverage. The policy that stands first in line is called the “primary insurance”. Many parties desire or are required to provide insurance in excess of the primary coverage. Such insurance is called “secondary or excess insurance” and it covers after the primary limits have been exhausted. If there is no secondary policy or if there is a secondary policy and the amount is insufficient to cover a loss, then somebody is self-insuring for losses above the coverage in place.

2. Casualty insurance insures against loss or damage resulting from fire or other casualty. In multi-tenant shopping centers, warehouses, office buildings and the like, the landlord generally carries the casualty insurance on the building and common area improvements, although the tenants may be required to make payment for same under the terms of the leases. Many single-user buildings or buildings in which a single tenant occupies substantial space are required to be insured by the tenant and, in the event of damage or destruction, the tenant is required to repair or restore the property.

a. It is not usual, although it is possible, for a landlord to self-insure its entire risk. Normally the self-insurance risk is taken by the landlord by increasing the amount of the deductible under the casualty policy.

b. From time to time the tenant may be permitted to self-insure its obligation to restore the landlord’s property, either by way of a large deductible or by way of no insurance at all.

c. Co-insurance problems may arise where property is insured for less than the full insurable value. If this a risk where one party agrees to self-insure the entire value of the property? If there is a risk, then who bears it? This would depend on the provisions of the lease.

3. Liability Insurance and Indemnification. Most leases attempt to allocate liability for negligence between landlord and tenant.

a. A landlord often requests a complete indemnity by the tenant for any act occurring on the premises or in the common areas, regardless of who is negligent. Tenants often refuse to bear such entire responsibility. A common compromise requires the tenant to be responsible for events occurring in the tenant’s premises of a multi-tenant building and for the landlord to be responsible for events occurring in the common areas of a multi-tenant building.
Responsibility is thus allocated based on the place where the events occur and not on who was negligent. Thus, each party indemnifies the other for events occurring in the agreed areas. If such indemnification obligation is insured, then the risk is shifted to the insurance company. In a single occupant building, the tenant bears the entire risk.

b. However, if a party is self-insured to any degree, such as by maintaining a large deductible for liability or indemnification coverage under a policy with modest policy limits, there is a possibility of such party having to pay substantial damages that may have resulted solely from the negligence of the other party. For example, if the landlord is responsible for events occurring in the common areas but the tenant leaves some obstacle in the parking lot, such as a shopping cart, and a third party is injured, then the landlord would be responsible to such third party under the provisions of the lease even though the injury was caused by the negligence of the tenant.

c. Although most jurisdictions enforce indemnification provisions in leases (see, 1 Milton R. Friedman, Friedman on Leases §9.10 (3rd ed. 1990)), some, such as New York and Illinois, have statutes which limit or prohibits indemnification against a party’s own negligence.

4. The allocation of risk for rental during the period of time when the premises are unusable by reason of damage or destruction is usually provided in the lease. If no provision is made for insuring rental loss during such period, then if the tenant is responsible to maintain rental, the tenant would be self-insuring such obligation. Similarly, if rent abates during such a period, the landlord will be self-insuring the rental which the landlord would otherwise receive and which is ordinarily required to pay operating expenses, taxes and mortgage payments. Taxes and mortgage payments do not abate during periods when the premises cannot be occupied by reason of damage or destruction, so the parties must consider the source of the funds to pay same while the property is being repaired.

E. Self-insurance may be treated as actual insurance for purposes of certain concepts of insurance law. For example, the self-insurer would take the responsibility for the obligation of defense which would include the right to choose counsel. If self-insurance is only the first layer of insurance, then it would be subject to the concept that the entirety of that layer of insurance must be paid before any excess insurance coverage is applicable. Does this impose on the self-insurer a duty to settle claims within the amount of the self-insurance or can it hold off making payments while negotiations or litigation continues with the excess carriers? One case held, in the medical coverage context, that a self-insurer, whose coverage overlapped with that of an insurance company’s coverage, would be liable for a pro rata share of the insurance claim based on the respective insurance policy limits. Mary Free Bed Hospital and Rehabilitation Center v. Insurance Company of North America, 345 N.W.2d 658 (Mich. App. 1983).
F. Subrogation – Does It Apply To Self-Insurance?

1. Subrogation permits one party to stand “in the shoes of another”. Thus, where a fire is caused by the negligence of a tenant and a landlord’s building is destroyed, if the landlord’s insurance company pays the cost of restoration it is subrogated to the landlord’s right to collect from the tenant because of the negligence of the tenant in causing the fire. Likewise, if the landlord caused the fire and the tenant’s inventory was destroyed, then the landlord might face a subrogation claim from the company insuring the tenant’s inventory.

2. Leases have traditionally dealt with the subrogation problem by providing for a mutual waiver of subrogation so that neither the landlord nor the tenant would be subjected to claims from the other’s insurance company. Often, leases do not provide for a waiver by each tenant of subrogation claims against other tenants. What happens in that situation is a discussion beyond the scope of this article.

3. If the landlord self-insures or the tenant self-insures, then does the mutual waiver of subrogation apply to prevent a claim against the negligence party? For example, although a tenant was obligated to provide amounts equivalent to insurance proceeds to repair or replace, does that mean it has also waived its subrogation claim, if any, since it is acting as an insurance company or is a separate specific waiver of subrogation rights required?

G. Rights of the mortgagee with respect to self-insurance.

1. Requirements for providing insurance and whether and to what extent self-insurance will suffice. Does the mortgagee have to accept self-insurance from the borrower or its tenant? Not usually.

2. Proceeds of self-insurance. Can they be applied to the mortgage balance by the mortgagee? If so, does the part required to self-insure have a subrogation right against the other party if not waived? How does the building get rebuilt?

II. Definition of Self-Insurance.

A. Self-insurance is very difficult to define because the term has so many diverse meanings and uses.

1. In essence, it is a risk financing technique whereby an entity uses its own funds to pay for all of its losses.

2. However, through time and usage, the term self-insurance has become synonymous with other risk management methods which may also include the purchase of insurance.

B. Risk management contributes to an entity’s overall profitability by planning, organizing, directing and controlling the sources and uses of funds with which an entity may finance its recovery from property, casualty and other losses.
1. The goal is to minimize the adverse effects that casualty and property losses might have on an entity’s ability to achieve its business objectives.

2. By reliably and cost-effectively providing funds to pay for and restore that entity’s losses.

III. Examining Feasibility of Self-Insurance.

A. The two basic risk financing alternatives are RETENTION (self-insurance is a form of retention, using one’s own funds to finance recovery from its losses and is often known as “SIR”, or “Self-Insured Retention”) and TRANSFER (using funds originally coming from an outside source to pay for such losses).

   1. The most common basic retention options in the property and casualty areas are
      a. paying for losses from cash flow
      b. using unfunded reserves
      c. using funded reserves
      d. borrowing.

   2. The most common basic transfer options are
      a. insurance
      b. contractual transfers (such as hold harmless, indemnity and exculpatory agreements in leases, lease requirements that the other party maintain insurance protection that would also protect the self-insured party and requirements for (i) waiver of subrogation endorsements to insurance policies or (ii) naming particular parties as additional insureds, both of which measures prevent a negligent party from being sued by an insurer for the recovery of losses paid by that insurer resulting from the negligent party’s actions).
      c. loss control measures, such as safety programs and other practices intended to reduce the possibility of property and/or casualty losses.

B. In selecting the best risk financing technique, an entity should choose the combination of risk financing techniques which

   1. Maximizes either the present value of its differential expected annual net cash flows or the time-adjusted rate of return on its resources, making the best use of an entity’s funds matching the amounts and timing of its needs for cash; and
2. Takes into account
   
a. an entity’s desire for financial security (which may lead an organization’s managers or owners [or politicians, in the case of a public entity] to choose the relatively more expensive technique of insuring rather than self-insuring even though self-insurance could generate a higher expected present value future net cash flow).

   b. Legal requirements, such as provisions in loan documents which require the maintenance of certain insurance and/or certain minimum asset to liability or other ratios or balance sheet requirements which might be violated upon a casualty or liability loss.

   c. Budget constraints, which may restrict an entity’s ability to consistently retain sufficient amounts of money to cover its loss exposures and for which the purchase of insurance is more prudent.

   d. Choosing and implementing the chosen risk financing techniques involves input from many different sources, including

      (1) risk management professionals, who have the responsibility for identifying and analyzing the potential losses to which the entity is subject and the maximum possible loss in dollars

      (2) insurance professionals, who can assist with pricing of premiums for insurance coverages

          (a) identified by risk managers as being essential or desirable to protect the insured against losses that would threaten the continued existence of the entity, and/or

          (b) with increased deductibles.

      (3) Senior management who can implement loss control measures designed to decrease the potential for losses (such as the installation of automatic fire suppression systems in a building) and who can make other business decisions relating to retention reserves and the purchase of insurance.

IV. Determining Which Property and Casualty Losses May Be Better Handled Through a Non-Insurance Method.

After the risk manager has determined the potential losses that may be suffered by an entity, a determination must be made as to which losses could be better handled without the purchase of insurance.

A. Property insurance coverage – Total self-insurance is generally not as common for property and casualty losses because the maximum possible losses that may be incurred could be much more than current budget constraints will allow (i.e., a Fortune 500 company could not
absorb a total loss of a $20,000,000 plant). The maximum possible property losses are more easily measurable than loss by liability (i.e., the replacement cost of the property destroyed). For property coverage, it is possible to determine how much insurance coverage is sufficient by analysis of the entity’s assets, but there are no limits to an organization’s potential liability losses. However, safety measures designed to minimize any event which could cause a fire or other casualty (e.g., the installation of automatic sprinklers, careful housekeeping, use of fire-resistant materials, annual physical examinations, night guards, etc.) may significantly reduce the insurance premiums and induce the entity to increase the amount of the policy deductible. Nevertheless, although some savings may occur through SIR on property and casualty insurance and by increasing deductibles, the savings may not be as significant as one might expect. A rule of thumb is that if an entity can save more in premiums than it assumes by increasing the amount of its deductible, then an increased deductible may be worthwhile. For example, an insurer in Richmond, Virginia recently made the following analysis for a hotel having a replacement value of $40,000,000:

1. For a Full Value Policy having a limit of liability of $40,000,000 and a $1,000 deductible for each loss, the estimated annual premium was $100,000 (subject to satisfactory inspections for engineering and acceptable breakdown of values between building, contents and business interruption to satisfy agreed amount requirements).

2. For a Loss Limit Policy (insuring only $20,000,000 of the $40,000,000 value):

<table>
<thead>
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<th>DEDUCTIBLE EACH LOSS</th>
<th>LIMIT OF LIABILITY</th>
<th>ANNUAL PREMIUM</th>
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<tr>
<td>(A) $100,000</td>
<td>$20,000,000(1)</td>
<td>$37,615</td>
</tr>
<tr>
<td>(B) $  50,000</td>
<td>$20,000,000(1)</td>
<td>$43,600</td>
</tr>
<tr>
<td>(C) $  25,000</td>
<td>$20,000,000(1)</td>
<td>$52,865</td>
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There are many ways to perform a risk analysis on the foregoing example, but note that the deductible is for each loss. This means that where there are high deductibles, multiple losses within any year could wipe out any premium savings achieved by such a high deductible. In addition, in the $20,000,000 loss limit policy, an increase in the deductible of $25,000 will save less than $25,000 in annual premium. SIR/deductible is often used to minimize rate increases or to make a risk acceptable to underwriters.

3. Additional premium savings might be available by purchasing 80% or 90% replacement value insurance and, if the entity has multiple locations, insuring all locations under a blanket policy, on the assumption that a fire or other casualty will not damage or destroy all of the separate locations. Although this increases the SIR of an entity, depending on the proximity of each location to the others and other factors, this is a common SIR technique for reducing total insurance premium costs.

4. Loss control measures.

(1) Excess layers of protection are available: $300 premium per $1,000,000 of coverage (subject to $5,000 minimum premium on options (B) and (C); option (A) already included minimum premium charge).
5. Shifting of risks of casualty losses to another party, e.g., a landlord requiring a tenant to maintain fire and extended coverage insurance.

6. Waiver of subrogation provisions in leases and endorsements in insurance policies.

B. Boiler and machinery insurance – This is generally regarded as essential coverage and the use of deductibles to retain small losses should be considered.

C. Commercial general liability – This is generally regarded as essential coverage, but SIR may be used advantageously.

1. Many of the same considerations are present in the analysis of liability risks as are present with the analysis of property and casualty risks. However, the maximum losses and the predictability of such losses are much more uncertain. There are many more variables involved in liability losses, and liability losses may have an unlimited potential. Indeed, every customer of a retailer is a potential third-party claimant of that entity. This results in much higher premiums for liability insurance than for property and casualty insurance.

2. There are so many variables in commercial general liability that it is not possible to give an accurate example showing pure premiums and deductibles. Each class of business has its own rate, based on large numbers of statistics gathered over many years to promulgate a rate for a typical risk within a class.

3. Although the following example may be misleading, it is useful to put into perspective the possible amounts of premiums required for a commercial general liability insurance policy purchased by a hotel entity:

The same Richmond, Virginia insurer quoted a commercial general liability premium of between $100,000 and $120,000 for $1 million of insurance (with a deductible per claim of $25,000). The insurer also quoted a premium of $300,000 for a $5,000,000 liability policy (with a deductible of $1 million).

4. Self-insurance programs for liability are usually suitable only for very large risks --- those having $1 million or more in standard premium with a majority of the premium being generated from Workers Compensation and general liability.

5. Workers Compensation and general liability claims tend to have “long tails” (payout over a number of years). Therefore, the financial impact on an insured would be distributed over a number of years and the true cost to the insured would be less than its actual SIR.

6. Present value analysis is used to calculate the amounts that need to be set aside for anticipated future claims. For example:
An organization which expects to incur $1 million of losses for a specific type of products liability exposure may decide to retain $1 million and purchase aggregate excess liability coverage above $1 million. If the organization wants to prefund the expected $1 million in losses, it may be possible for that entity to invest only approximately $827,800 today to have the funds necessary to pay out $1 million assuming that the payout may be made in three equal annual installments of $333,000, a 10% interest rate, compounded annually and that no income taxes will be payable on the investment income.

7. From the perspective of an insured, it is most advantageous to retain predictable, and therefore, budgetable liability losses (also referred to as “normal losses” or “expected losses”) which have a low potential severity and to transfer all other losses to insurance companies. Normal or expected losses have a high frequency of occurrence and, therefore, are statistically predictable.

8. In order to address the potentially adverse impact on an entity where a larger than expected number of losses increases the actual dollar amount retained beyond that which was originally anticipated, an organization, especially a small business, may join with other small organizations in a “pool.” A “pool” is generally composed of insureds having similar exposures which, by coming together, spread their risk to such exposures; reduce the costs of settling claims, as compared to the costs incurred by commercial liability insurers; and coordinate a strong safety and loss control program to meet the group’s specific needs.

D. Desirable or Available Coverages – The risk manager may determine that certain insurance coverages may be desirable (i.e., coverage against losses that would cause the entity serious economic distress but would probably not force the entity to cease its operations, such as vandalism insurance and fire legal liability insurance) or available (i.e., coverages against losses that may be of some value but deal with losses that are likely to be small or happen very infrequently, such as earthquake insurance, flood insurance, glass insurance or water damage insurance). The case may be made that an entity’s loss control activities can be effective enough in these areas to make retention attractive because the resulting maximum loss or the loss frequency is so small.

V. Excess Insurance and Umbrella Insurance.

A. Excess insurance provides coverage above an entity’s SIR, but offers no broader protection than does any underlying insurance coverage or SIR. Excess insurance can be written to cover liability and property losses.

B. Umbrella insurance provides excess layers of protection over underlying policy limits or over the SIR. Umbrella coverage is usually more expensive than excess coverage. Typically applies only to liability exposures.
C. Excess and Umbrella insurance policies can strengthen an entity’s risk financing program by providing a means to protect against any loss which exceeds the upper limit of an SIR. In effect, the upper limit of the SIR provides a deductible for the excess or umbrella insurance coverage.

D. Annual Aggregate Excess Insurance is most commonly used with SIRs. It does not pay any losses until the total amount of losses in a given year reaches the specified retention for that year. An entity retaining its own losses often is unable to pay additional losses, and the viability of its retention program may be dependent on annual aggregate excess coverage to provide stability upon an extraordinary accumulation of smaller losses or by an unusually large single loss.


A. First, establish the type and nature of insurance required to be carried under the lease.

1. Casualty insurance providing all risk coverage with full replacement cost and an agreed value endorsement.

2. Liability insurance with limits of One Million Dollars ($1,000,000) for each person and Three Million Dollars ($3,000,000) for each event (or greater as the circumstances dictate).

3. Business interruption or rental insurance.

B. Qualifications of Insurance Companies’ Best Ratings and licensed in the State.

C. Other considerations in the event of self-insurance.

1. Once the insurance obligations are clearly established and the type and extent of insurance that is to be required has been detailed, as set forth above, then the type and extent of the self-insurance can follow the insurance to be carried as if there is no self-insurance permitted.

2. In the event of self-insurance, the tenant should be required to issue an insurance certificate to the landlord and to the landlord’s mortgagee specifying the self-insurance coverage provided by the tenant. For example, the certificate should specify the type of casualty coverage (e.g., replacement cost with agreed value endorsement) and the amount thereof. Such insurance coverage should name the mortgagee under a standard mortgagee clause which will provide that mortgagee is not subject to any defenses that the tenant may have with respect to payment.

3. Care must be taken to be sure that the landlord’s mortgagee approves self-insurance by the tenant.

4. The lease should require that the self-insurance certificate confirm that the tenant permits and has waived subrogation.
5. Adequate assurance of the tenant’s financial responsibility should be required under the terms of the lease. The tenant is to maintain any reserves agreed to cover the risk insured. The tenant is to provide annual statements to landlord and landlord’s mortgagee to confirm the required net worth to permit it to self-insure; otherwise, the right will be lost.

6. If, under the provisions of the casualty clause, the lease would terminate in the event of a casualty because the period required to restore would be longer than that provided by the lease, then the tenant should be required to deliver to the landlord [and landlord’s mortgagee] an amount equal to the insurance proceeds otherwise payable to the landlord under the terms of the insurance policies that would be maintained absent the self-insurance.

7. If the tenant self-insures its liability coverage, it must bear the cost of the defense of any claim, including the defense of the landlord, as well as the obligation to pay any judgment or settlement.

8. If the lease does not contain an operating covenant and the premises are destroyed by damage or destruction and the tenant determines that it will not reopen, then the landlord [and landlord’s mortgagee] should have the alternative to require the self-insurance proceeds (i) to be paid directly to it for restoration in such form and condition as the landlord may require, and the tenant must continue to pay rent for the premises (subject to the landlord’s duty to mitigate) or (ii) to be paid to the landlord and the lease would terminate.

D. Establish the responsibilities of the parties in the event of a loss.

1. If the landlord is carrying the casualty insurance, then the landlord would have the obligation to rebuild provided, it could do so within 120 days (for example), and if the damage or destruction could not be repaired within 120 days; then either the landlord or the tenant could terminate the lease. Once the landlord commences to rebuild, the lease cannot be terminated provided the landlord diligently prosecutes the reconstruction to completion, subject to force majeure.

2. If the tenant is the sole occupant of the premises, then the tenant might be obligated to rebuild using the proceeds of insurance. If the tenant self-insures, then the tenant would be obligated to rebuild using funds provided by the tenant.

3. As far as liability coverage is concerned, insurance would be required as set forth above. But, if the lease permits, the tenant may self-insure some portion of the required coverage by being permitted to maintain a large deductible or to self-insure for a large amount. The tenant, if self-insuring, might also self-insure the first $___________ of loss in the event of casualty and be required to carry secondary or excess insurance for the balance.

4. The lease should provide who bears the risk of rental loss during the period of rebuilding in the event of casualty. If it is the tenant, then the tenant should be
obligated to carry insurance to provide rental payments during the reconstruction phase. However, the tenant might be permitted to self-insure such risk.
Exhibit A

Lease Model Provision

1. Tenant shall pay for and maintain or cause to be paid for and maintained, from the date of commencement of the construction of the Leasehold Improvements through the end of the Term, the following policies of insurance covering the Premises, which insurance shall be obtained from companies currently rated “A/X” or better as defined in the then current edition of Best’s Insurance Reports (or the equivalent thereof if Best’s Insurance Reports is no longer published) and is licensed to do business in the State where the Premises are located:

   (a) Workers’ Compensation Insurance covering Tenant and its employees for all costs, statutory benefits and liabilities under State Workers’ Compensation and similar laws for employees of Landlord, and Employer’s Liability Insurance with limits of ___________________________ Dollars ($__________________) per accident or disease.

   (b) Commercial General Liability Insurance covering the Premises with coverage for premises/operations, products/completed operations, contractual liability, and bodily injury with combined single limits of not less than ___________________________ Dollars ($__________________) per occurrence for death, bodily injury or property damage, including Landlord as an additional insured.

   (c) “All Risk” Property Insurance (now known as Special Perils Insurance) upon all buildings, building improvements, personal property owned by Tenant and alterations on the Premises, including, but not limited to, those perils generally covered in an all risk policy, including fire, extended coverage, windstorm, vandalism, malicious mischief, sprinkler leakage, flood and earthquake coverage in the amount of eighty percent (80%) of full replacement cost and with “increased cost of construction”, “agreed value” and “extra expense” endorsements and all other endorsements reasonably requested by Landlord from time to time.

   (d) Rental Loss Insurance.

2. The specified limits of insurance may be satisfied by any combination of primary or excess/umbrella liability insurance policies. At the end of each five (5) years of the initial Term, and at the beginning of each extension period Tenant shall review with Landlord the coverages and limits of any or all of the policies required above and, at that time, shall cause such coverages and liability limits to be increased as reasonably required by Landlord in view of inflation and other relevant factors.

3. Each policy shall expressly provide that it shall not be subject to cancellation or material change without at least thirty (30) days’ prior written notice to Landlord, that the coverage provided by such insurance policy shall be deemed primary insurance and that any insurance provided by or on behalf of Landlord shall be in excess of any insurance provided by such policy. Tenant shall furnish Landlord, or cause to be furnished to Landlord, currently with
the execution of this Lease, and prior to the inception of each successive policy period, insurance
certificates and, upon request by Landlord, copies of such policies required to be maintained
hereunder naming Landlord as an additional insured thereunder. Upon request of Landlord,
Tenant shall also provide coverage under such insurance (or so much thereof as Landlord may
require) for the benefit of the Landlord’s Mortgagee holding a lien on the Premises and shall
name such Mortgagee under a standard mortgage provision. All policies required to be provided
by Tenant hereunder shall include an endorsement to show that such insurance carrier
acknowledges the waiver of subrogation in favor of Landlord contained in paragraph ___ below.

4. Tenant shall have the right to self-insure for the Commercial General Liability
Insurance, the “All Risk” Property Insurance and the Rental Loss insurance required above,
subject to:

   (a) “Self-insure” shall mean that Tenant is itself acting as though it were the
   insurance company providing the insurance required under the provisions hereof and
   Tenant shall pay any amounts due in lieu of insurance proceeds because of self-insurance,
   which amounts shall be treated as insurance proceeds for all purposes under this Lease.

   (b) All amounts which Tenant pays or is required to pay and all loss or
damages resulting from risks for which Tenant has elected to self-insure shall be subject
   to the waiver of subrogation provisions of paragraph ____ hereof and shall not limit
   Tenant’s indemnification obligations set forth in paragraph ____ hereof.

   (c) Tenant’s right to self-insure and to continue to self-insure is conditioned
upon and subject to:

      (i) The Tenant having a net worth of at least ___________________
         Dollars ($________________). The amount of Tenant’s net worth requirement
         shall be increased by ___________________ Dollars ($________________)
         at the end of each five (5) years of the initial Term and at the beginning of each
         extension term of the Lease;

      (ii) The Tenant providing an audited financing statement, prepared in
         accordance with generally accepted accounting principles, to Landlord [and
         Landlord’s mortgagee] by May 1 of every year which establishes and confirms
         that Tenant has the required net worth;

      (iii) No events occurring that make it apparent that such net worth has
         been diminished below the required level (such as the bankruptcy of Tenant); and

      (iv) The Tenant maintaining appropriate loss reserves which are
         actuarially derived in accordance with accepted standards of the insurance
         industry and accrued (i.e., charged against earnings) or otherwise funded.

   (d) In the event Tenant fails to fulfill the requirements of 4(c), then Tenant
   shall immediately lose the right to self insure and shall be required to provide the
   insurance specified in paragraphs 1, 2, 3.
5. In the event that Tenant elects to self-insure and an event or claim occurs for which a defense and/or coverage would have been available from the insurance company, Tenant shall:

   (a) undertake the defense of any such claim, including a defense of Landlord, at Tenant’s sole cost and expense, and

   (b) use its own funds to pay any claim or replace any property or otherwise provide the funding which would have been available from insurance proceeds but for such election by Tenant to self-insure.

6. In the event Tenant has the right to and elects to not operate its business in the Premises after reconstruction, or fails to commence reconstruction within _____ days after requested by Landlord, Landlord shall have the right to determine that the self-insurance proceeds either be paid to Landlord:

   (a) for restoration of the Premise to such form and condition as Landlord may reasonably require, and the Tenant’s other obligations under the Lease shall continue in full force and effect, or

   (b) such proceeds be paid to Landlord and the Lease shall thereupon terminate.

7. In the event that Tenant elects to self-insure, Tenant shall provide Landlord and Landlord’s Mortgagor with certificates of self-insurance specifying the extent of self-insurance coverage hereunder and containing a waiver of subrogation provision reasonably satisfactory to Landlord. Any insurance coverage provided by Tenant shall be for the benefit of Tenant, Landlord and the first Mortgagee, as their respective interests may appear and, shall name Mortgagee under a standard mortgage provision.
Exhibit B

Form Letter from Tenant to Mortgagee

To Lender:

(the “Tenant” is the lessee under a certain lease dated ______________, 1995, between ______________, as lessor (the “Borrower”), and the Tenant, as lessee (the “Lease”). We understand that ______________ Insurance Company (the “Lender”) is making a mortgage loan to the Borrower (the “Loan”) to be secured by the real estate which is the subject of the Lease (the “Property”).

Pursuant to your request, this is to confirm that the Tenant will self-insure against casualties caused by fire and other casualties typically covered by all risk, liability and rental loss insurance, as required by the Lease, and that the Tenant and its parent (the “Parent”), which has guaranteed the Lease, have a combined net worth as of ______________ of __________________________ Dollars ($________________).

Loss or damage, if any, payable under the self-insurance shall be payable to the Lender, as its interests may appear, or any future mortgagee providing financing for the property and such insurance shall not be invalidated by (i) any act, omission or negligence of the Lender or the Borrower, (ii) by any foreclosure or other proceedings relating to the sale or other transfer of the Property, (iii) by any change in the title or ownership of the Property or, (iv) by the occupation of the Property for purposes more hazardous than are permitted by the Lease.

The self-insurance is subject to the waiver of subrogation provisions of Paragraph ___ of the Lease and shall not limit the Tenant’s indemnification obligations under Paragraph ____ of the Lease.

You are authorized to rely upon the representations provided herein in making the Loan to the Borrower. The Tenant understands that if the Lender determines that the Tenant and the Parent do not have the financial capacity to cover such risk, the Lender may require the Borrower to obtain insurance policies insuring against such risks, the failure of which will constitute an event of default by the Borrower under the Loan. However, nothing herein shall impose any liability on the Tenant to pay for such insurance so long as it meets the requirements under the Lease of the Conditions of Tenant’s right to self-insure.
Exhibit C

Typical Lease Provisions

Clause I

Notwithstanding the foregoing, Tenant shall have the right to self-insure for the property damage insurance required under Section _____, provided that (i) Tenant, in consideration of Landlord’s waiver of Tenant’s obligation to obtain insurance from a third party, furnishes Landlord with certificates of self-insurance for the insurance otherwise required herein, which self-insurance certificates shall contain a waiver of subrogation clause reasonably satisfactory to Landlord, and (ii) all loss or damages resulting from risks for which Tenant has elected to self-insure shall be deemed insured claims for purposes of the waiver of insured claims set forth in Section _______. Landlord may revoke the foregoing waiver of Tenant’s obligation to carry third party property damage insurance if Landlord reasonably determines that Tenant’s creditworthiness or self-insurance programs are inadequate to protect the interests of Landlord hereunder.

Clause II

Tenant agrees that it will at all times after the commencement of the initial term and at its own expense keep its demised store building insured against loss or damage by fire with standard extended coverage endorsement in an amount equal to not less than eighty percent (80%) of its insurable value. Such insurance shall be carried in Landlord’s and first mortgagee’s and Tenant’s names, as their respective interests may appear. Certificates of the insurers evidencing insurance carried on or respecting the demised building shall be deposited by Tenant upon Landlord’s request. In lieu of such insurance, Tenant may insure the demised building against such loss or damage by means of any plan of self-insurance which Tenant may have in effect which meets the conditions set forth in Paragraph ____, provided that Tenant shall maintain a reserve adequate for the risks covered by such plan. Any insurance coverage herein provided for shall be for the benefit of Landlord and first mortgagee and Tenant, as their respective interests may appear, and all sums payable thereunder shall be paid to and held and disbursed by the first mortgagee as a trust fund for the purpose of paying the cost of restoring or rebuilding the premises in case of such loss or damage in accordance with this lease. Should any amount of insurance proceeds remain after completion of and payment for the work performed, such amount shall be released to and retained by and belong to Tenant. Tenant shall have the right and authority to adjust losses and execute proofs of loss under such policies in the name of Landlord, Tenant, first mortgagee, or all of them. If the demised store building is not repaired or restored, Tenant shall turn over to Landlord or Landlord’s mortgagee the proceeds of insurance payable by reason of the damage.
Clause III

Insurance coverage required herein may contain the following elements, so long as the required coverage is not diminished, the required limits are not reduced, and the elements thereof are otherwise commercially reasonable: a Party’s insurance program may include blanket, layered, umbrella, conventional and/or manuscript forms of policies, as well as retention levels and loss reserves which are charged against earnings or otherwise funded, and commercially reasonable deductibles.

The Parties shall have the right to satisfy their respective insurance obligations hereunder by means of self-insurance to the extent of all or part of the required insurance, but only so long as: (i) the self-insuring Party (or an affiliate providing the self-insurance) shall have a net worth of at least Fifty Million Dollars ($50,000,000.00); (ii) the self-insuring Party (or the affiliate providing the self-insurance) shall, upon request, provide an audited financial statement, prepared in accordance with generally accepted accounting principles, showing the required net worth; and (iii) such self-insurance provides for loss reserves which are actuarially derived in accordance with accepted standards of the insurance industry and accrued (i.e., charged against earning) or otherwise funded. Any deductible in excess of Ten Thousand Dollars ($10,000.00) shall be deemed to be self-insurance.

Upon request, each Party shall cause certificates of insurance reasonably evidencing compliance with the requirements of this Article to be delivered to the other Party. The insurance policies and certificates required by this Article shall require the insurance company to furnish Landlord and Tenant, as the case may be, thirty (30) days prior written notice of any cancellation or lapse, or the effective date of any reduction in the amounts or scope of coverage.

Clause IV

Tenant shall be permitted to self-insure its obligations under this Section 13.2 provided Tenant maintains a net worth of at least Twenty Million and No/100 Dollars ($20,000,000.00). Tenant’s right to self-insure under this Section 13.2 is contingent upon Tenant providing to Landlord current audited financial statements (including a balance sheet) annually. If Tenant does not provide then current audited financial statements within thirty (30) days after written demand by Landlord, such demand to be given only after the anniversary of the date Landlord receives Tenant’s previous audited financial statements, then Tenant shall not have the right to self-insure under the provisions of this Section 13.2 until Tenant provides to Landlord then current audited financial statements showing a net worth of at least Twenty Million and No/100 Dollars ($20,000,000.00). Tenant may carry such insurance under its blanket policy provided Landlord is given evidence thereof.

Clause V

Tenant shall maintain in respect of the Premises a comprehensive general liability policy of insurance with minimum limits of liability single limit for injury to any persons and damage to property of at least Five Million Dollars ($5,000,000.00), or such higher amount as Landlord
may reasonably request provided that such higher limits are generally carried by chain [type of store] operating stores of similar size in the greater [location] area. Such insurance may be carried with a responsible stock or non-assessable mutual insurance company, as selected by Tenant, authorized to do business in Ohio and may be provided under a so-called blanket policy of insurance (provided the coverage afforded Landlord and any such other parties in interest will not be reduced or diminished by reason of the use of such blanket policy of insurance) covering, in addition to the Premises, other locations of Tenant. Tenant shall deliver to Landlord the certificate of such insurance prior to the Delivery of Possession and a renewal certificate thereof at least fifteen (15) days prior to the expiration of any existing policy. All insurance required hereunder shall name Landlord and any mortgagee or other party reasonably designated by Landlord as an additional party insured thereto with any obligation to pay the premium and shall provide that Landlord and any mortgagee or any other party designated by Landlord will receive at least thirty (30) days’ notice prior to the cancellation or a material adverse change thereto. So long as Tenant, or any guarantor guaranteeing Tenant’s insurance obligations under this Article 26, has a net worth of at least Fifty Million Dollars ($50,000,000.00) during the Original Term, which net worth requirement shall be increased by Ten Million Dollars ($10,000,000.00) during each Extension Term, as evidenced by documents reasonably satisfactory to Landlord, Tenant may, upon notice to Landlord, elect to satisfy the insurance requirements under this Article 26 through self-insurance.
Bibliography


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