February 2013

mcmillan real estate bulletin

waivers of subrogation in leases – the latest chapter

In a typical commercial lease each of the landlord and tenant will have various insurance obligations. The lease will also have various provisions that allocate risk between the landlord and the tenant, with the allocation often consistent with the insurance obligations.

One common regime in respect of insurance and risk is to provide a mutual release whereby each of the landlord and tenant release the other in respect of damages and losses that are covered by the insurance required to be obtained by the releasing party. For example, a tenant will typically be obligated to insure its personal property in the premises and the landlord will therefore be released from any damage to that property, even if caused by the landlord. Similarly, the landlord will typically be obligated to insure the building itself (with the ability to charge the cost as an operating cost) and therefore the tenant will be released from any damage to the building even if caused by the tenant.

A lease may provide for this regime by way of mutual releases as described above and/or by waivers of subrogation from their respective insurers. Under a waiver of subrogation, the insurer gives up its right to subrogate and proceed against the party that has the benefit of that waiver even when that party caused the insured loss. The release is equally effective because the insurer can have no greater rights than the insured and, if the insured has already released another party, the insurer is bound by that release.

The recent case of Williams-Sonoma Inc v EllisDon Corporation involves the interpretation and application of a mutual release.[1]

This case involves water damage to certain premises of tenants at Yorkdale Mall. The damage was caused by a vandal entering the mall and opening a fire hose cap in certain space occupied by EllisDon in connection with construction activities. Those tenants started an action against EllisDon for the damages suffered. EllisDon brought a motion for judgment submitting that there was no genuine issue requiring a trial.

The position put forward by EllisDon was based on the following:

1. the Yorkdale form of lease (like most commercial leases) requires the tenants to place and maintain insurance to cover water damage claims on their premises;

2. the landlord is obligated to maintain similar insurance for its property;

3. there is a mutual release and waiver between the landlord and the tenant for any occurrences which are the subject of insurance coverage;

4. the mutual release was drafted so it extends to damage caused not only by the other party but also by any other person for whom the party benefitting from the release is in law responsible; and

5. as a result, EllisDon submitted that the waiver of subrogation prevents the tenants from bringing an action against EllisDon because EllisDon is an entity for whom the landlord was responsible and the tenant released the landlord and all those for whom it is in law responsible from water damage, even

[1] Williams-Sonoma Inc v EllisDon Corporation, 2012 ONSC 5448.

where the landlord and those for whom it is responsible was the cause.

EllisDon was successful. The court held that the purpose of the lease terms is to allocate risk between the landlord and the tenant and to require each party to insure its portion of the risk. While there is a general legal principle that a person must be a party to a contract in order to benefit from it, the court held that such doctrine did not operate here. To prevent a third party from relying on a limitation of liability clause, such as is found in this lease, would not respect allocations and assumptions of risk made by the parties to the contract and would ignore the practical realities of insurance. It was exactly this kind of situation that was contemplated as coming within the scope of the lease.

As a result, the tenants would have to look to their insurance in order to recover any losses from the water damage. The landlord and EllisDon (being a party for whom the landlord was in law responsible) were not liable as that risk had been allocated to the tenant under the terms of the lease.

by William (Bill) Rowlands

For more information on this topic, please contact:

Toronto William A. Rowlands 416-307-4065 william.rowlands@mcmillan.ca

cautionary note