

## Who Should Bear The Risk?

The debate between landlords and tenants over what happens if there is damage to premises by an uninsured risk is more prevalent than ever. With the recommendations in the Code of Leasing Business Premises in England and Wales 2007 (“the 2007 Code”) and the current risk of terrorist attacks and floods, there is increasing awareness of the need for leases to clearly address this issue.

### Historical Position

Historically, “institutionally acceptable” leases would generally contain covenants on the part of the landlord:

- to insure the premises against specified insured risks;
- to reinstate the premises in the event of damage or destruction by an insured risk;
- for rents to be suspended during such reinstatement for the loss of rent period insured against.

There would also usually be a mutual termination right in the event that the premises had not been reinstated within the loss of rent period insured. The landlord’s insurance covenant would normally be qualified to apply only to the extent that the specified insured risks could be insured against in the UK insurance market and, in some cases, at reasonable commercial rates.

These provisions mean that if premises are damaged by a risk which the landlord is not obliged to insure against, the landlord’s covenant to rebuild and/or reinstate will not apply. The tenant will be required to pay rent for the remainder of the term and cannot terminate the lease. In addition, it is likely that the tenant’s repairing covenant would be wide enough to oblige the tenant to reinstate. This is of particular concern for a tenant when the damage or destruction is so severe that the tenant is unable to conduct its business from the premises, but would still be liable for the rent for the remainder of the term.

### A Shift in Position

There has been a definite shift in the market towards sharing the risk between the landlord and the tenant. This stance has been further supported by the recommendations of the 2007 Code. In particular, paragraph 9 of the 2007 Code recommends that “rent suspension should apply if the premises are damaged by an... uninsured risk other than where caused by the deliberate act of the tenant” and supports the tenant’s right to terminate where the whole of the premises are damaged by an uninsured risk so as to prevent occupation, save where the landlord agrees to rebuild at its own cost.

Where damage by an uninsured risk is shared between the parties, a frequently reached compromise in leases is now as follows:

- the landlord has a time limit (e.g. 6 to 12 months) within which to elect to repair/reinstate the premises at its own cost;
- if the landlord fails to elect within the designated time limit the parties are able to determine the lease;
- if the landlord does elect to reinstate the premises it will notify the tenant in writing of its intention to do so and such rebuilding and reinstatement will be on the same terms as if the damage had been caused by an insured risk under the lease.

Rent abatement in these circumstances will ultimately come down to the commercial bargaining strength of each party. The most common approach is for the tenant to pay rent during the landlord's election period and for the rent to be abated during the reinstatement of the premises following the landlord's election. Less common approaches include the tenant receiving an entire rent abatement, or the tenant receiving no rent abatement during either the election or rebuilding period.

Given the current climate and the risk that specified insured risks may become uninsurable during the term of the lease, it is imperative that landlords and tenants give careful consideration to this matter at the outset of lease negotiations and it should form part of the heads of terms. Similarly, tenants taking an assignment of an existing lease must carefully check the insurance provisions to determine whether the lease affords sufficient protection.

It is evident from the recommendations of the 2007 Code that best practice in commercial lease negotiations is that all leases should contain clear and specific provisions governing what happens if there is damage or destruction by an uninsured event.

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