The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

# Insuring the Civil Liability of Firms Managing and Operating Commercial Real Estate

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March 26, 2012

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Despite the obvious advantages for owners of commercial real estate to engage management companies, the issues inevitably arise of apportioning liability and potential risks between an owner of a building and a management company and of how to reduce these risks.

Current legislation does not stipulate that it is compulsory to take out insurance against either the civil liability or professional liability of commercial real estate management companies. The need for such insurance is to a large degree down to the objective need for commercial protection. Currently, the insurance of the risks of management companies is largely governed by general civil law rules on insurance; at the same time, unified approaches to insuring such risks are only just beginning to take shape on the commercial real estate management market, and specific rules have not yet been developed.

The scope of a management company's liability largely depends on the scope of its responsibilities at a specific real estate facility. However, even if it has the most limited range of powers, a management company's activity always carries a risk of damage being caused to property, as well as to the life and health of third parties.

The most topical time of insurance service is the insurance of management companies' civil liability, and this, as well as the insurance of the property entrusted to them to be managed, is as a rule only insured when the management agreement includes a term requiring this. In addition, the burden of insuring real property belonging to it often falls on the owner.

It is becoming an ever more necessary and standard requirement in tenders for management companies to insure their own civil liability, since this is an effective way to safeguard the interests of the management company and the owner alike.

On the one hand, insurance allows the management company to optimize its business processes and to ensure that it gives timely and appropriate compensation to persons who have suffered loss, this in turn making its services more attractive. On the other hand, the owner receives a financial guarantee of loss being compensated promptly, irrespective of the financial standing of the management company it has engaged.

## INSURED EVENTS AND INSURANCE COVERAGE

The list of insured events associated with the management of modern office buildings may be linked to the maintenance and repair of buildings' engineering systems and general services, as well as to the cleaning of buildings and the land adjacent to them, the safeguarding of security and safety, and to the activity of any subcontractor companies that are hired.

Information from insurance companies suggests that insured events are most often linked to leaks, flooding and fires, which are generally caused by errors in operating engineering systems resulting in damage being caused to third parties (such as tenants). Nevertheless, the likelihood of any given insured event occurring depends on the particular circumstances, the specific features of the business center in question and the nature of the management company's activity.

The list of expenses covered by an insurance payout may vary significantly depending on the amount of the insurance premium. However, it generally includes the following:

- expenses associated with compensating harm caused to the life and health of third parties and also to their property;
- expenses in ascertaining the circumstances and causes of an insured event, establishing the policyholder's fault in the causing of damage and assessing the damage caused;
- expenses on conducting an expert review expenses on defending the policyholder, including court costs (not least, paying lawyers' fees);
- expenses to mitigate losses caused by an insured event and damage to third parties;
- other expenses (expenses in compensating loss of earnings, restoring injured parties to health and putting them in a condition to return to work, and so on).

Recently, insurance companies have often included in insurance coverage compensation for mental distress, since the amounts of such compensation awarded by courts are becoming ever more noticeable, yet including such a possibility in the insurance coverage does not result in the insurance being significantly more expensive.

A further element of insurance coverage may be the lost profit of third parties. However, it is extremely difficult accurately to assess the amount of lost profit and this may, in addition, increase the cost of an insurance premium by several times. To this end, insurance companies tend to prefer to exclude such losses from insurance coverage, or to place a strict cap on the coverage, with payouts made only further to a court decision that has taken legal effect.

Particular attention should be paid to insurance that applies an excess. One of the benefits of an excess is that it entails a reduction in the cost of an insurance policy, as well as allowing a policyholder to deal on its own account with issues relating to the handling of minor claims (and this means that an increase can be avoided in the cost of the insurance when the policyholder extends it). In addition, when selecting an insurance model that applies an excess, a management company should take into consideration both the particular nature and frequency of insured events and the amount of the excess.

## ALLOCATING LIABILITY AND A CAP

The fact that a loss has occurred may be due to various factors, which may occasion liability for several parties, including the management company, the owner, tenants, subcontractor companies, visitors and other third parties. Thus, the optimum balance of interests is possible only when each party that is involved in operating the real estate facility is properly insured.

Ever more frequently, the above parties strive to nail down issues relating to the allocation of risks and insurance of liability directly in management contracts and lease contracts. Insurance companies are also attempting to take account of the specifics of this issue, proposing integrated insurance programs. However, as things stand, no single practice has yet evolved for applying these programs, which means that it is not possible fully to assess the advantages and drawbacks of such insurance models.

Moreover, it should be borne in mind that, when a management company and the owner of a building insure liability within the scope of a single policy, it is possible that mutual claims will not be treated as insured events. At the same time, when they insure under independent contracts, even with the same insurer, mutual claims will be treated as independent insurance events.

Insurers also propose including in a management company's civil liability insurance policy issues regarding the liability of subcontractor companies.

When the amount of a management company's liability limit is determined in an agreement for the management of a real estate facility, owners should bear in mind the scope of the work and services that the management company is to perform and provide, the complexity, the initial state and individual features of the facility, the extent to which the management company's staff are qualified, the management company's experience of working on the commercial real estate market and its reputation, and so on.

Issues relating to the allocation of risks and the insurance of the civil liability of management companies are becoming ever more significant. In view of this, it is becoming standard practice to include a term dealing with the management company's civil liability in management contracts for commercial real estate.

To this end, the choice of insurance company must be approached with great care, to ensure that it offers both parties the best set of insurance services. The approach to insuring civil liability should be comprehensive and founded on an appropriate allocation of risks among all parties involved in operating real estate facilities as well as on a balanced assessment of those risks. Unfortunately, at present on the insurance market there remains, just as there previously was, a lack of high-quality insurance products that could not only meet general statutory requirements but also take account of the individual needs of the management company and the owner of a building in each specific case.