Pursuing a subrogation claim against an insured's tenant who negligently damaged leased property can be fraught with challenges. A considerable hurdle is the Implied-Coinsured Doctrine - a legal fiction created to bar subrogation claims against tenants as a matter of public policy. However, depending on the jurisdiction and the underlying lease agreement, this hurdle may be overcome. A detailed analysis of the law of the relevant jurisdiction and the underlying lease agreement must be performed in order to determine if the insurance carrier of a landlord may recover against the tenant that caused the property damage.

Hypothetical

A tenant in a multi-unit apartment complex lights a candle or starts to cook dinner on the stove. The tenant is distracted or leaves the apartment with the lit candle or the stove unattended. A fire occurs and destroys not only the tenant's unit, but numerous other units as well. The landlord's property carrier pays for the resulting damage and wants to pursue a claim against the negligent tenant who caused the loss. May the landlord's insurance carrier bring a subrogation claim against a negligent tenant who damaged the landlord's property?

This scenario is all too common - and unfortunately, there is no universal answer. Depending on the jurisdiction in which the loss occurred you may be faced with three different results: the carrier may not sue the tenant because the tenant is proclaimed to be an insured under the landlord's policy as a matter of law; the carrier may sue the tenant, unless the lease expressly excludes or waives subrogation; or the court will
perform a case-by-case analysis relying on the lease, the type of premises, public policy considerations and traditional contract interpretation. Below is a brief discussion of the discrepancy in the law between jurisdictions and the latest trend on how courts are addressing this issue. Also, please refer to the firm's updated 50-State Survey regarding whether an insurer may pursue subrogation claims against its insured's tenant. Regardless of the jurisdiction, your analysis must begin with reviewing the subject lease.

The Anti-Subrogation Rule

One of the fundamental principles of insurance law is that an insurer may not bring claims against or recover from its insured, or co-insured, even if the insured negligently caused his own damages. This is known as the anti-subrogation rule. In subrogation, the insurer stands in the shoes of its insured and inherits all of the insured's rights and limitations as against a culpable third-party. Allowing an insurer to subrogate against its own insured would create a legal absurdity - the insured would essentially be suing himself to recover damages he sustained by his own conduct. Interestingly, some courts across the United States have expanded the anti-subrogation rule by creating a fictional relationship between the tenant and the landlord's insurance carrier holding that the tenant is an implied co-insured - even though the tenant is not named in the insurance policy and there is no express language in the lease stating that the tenant will be covered by any insurance policy obtained by the landlord.

The Sutton Doctrine - tenant is an implied co-insured

In 1975, the Oklahoma Court of Appeals expanded the anti-subrogation rule by creating the legal fiction that the tenant was an implied-coinsured of the landlord. Sutton v. Jondahl, 532 P.2d 478 (Okla. Ct. App. 1975). To reach this holding, the court made very strained and deliberate assumptions. Without any evidence or testimony regarding the tenant's reasonable expectations or understandings when he entered into the lease, the court sua sponte presumed that prospective tenants ordinarily rely upon the landlord to provide fire insurance to protect them. Id. at 482. The court went on to explain that because both the landlord and the tenant have an insurable interest in the rented premises - the landlord owns the premises and the tenant has a possessory interest in the premises - the landlord purchased the fire insurance to protect both insurable interests in the premises. Id. From that logic, the court concluded that the tenant paid the landlord's insurance premium as part of the monthly rent. Id. The court created this legal fiction to shield the tenant from his own liability and place the assumption of the risk solely on the landlord's carrier. The express rule set out in Sutton is that absent an express provision in the lease establishing the tenant's liability for loss from a negligently started fire, the landlord's insurance policy would be held for the mutual benefit of both parties.1 Unfortunately, the federal district court sitting in Oklahoma expanded this rationale to the commer-
cial lease context - despite the fact that you have two sophisticated parties negotiating the terms and conditions of the lease. *Hanover Insurance Co. v. Honeywell, Inc.*, 200 F.Supp 2d. 1305 (N.D. Okla - 2002).

Numerous states have followed Oklahoma's lead and have held that without express language in the lease allowing for subrogation or stating that the tenant is liable for damages caused by his own negligence, the tenant is an implied coinsured and safe from being held accountable. These states are Alaska, California, Connecticut, Delaware, Maine, Massachusetts, Michigan, Minnesota, Nevada, New Hampshire, North Dakota, Tennessee, Utah, and Washington. Although reaching the same conclusion, the courts have relied on differing rationales: from pure public policy in that the insurance carrier assumed the risk and assumed that tenants would occupy and might damage the premises; to economic waste (why impose upon a tenant the burden of obtaining insurance to protect not only their unit but the entire complex, when the landlord has already insured the entire complex); to holding that the tenant and landlord both hold an insurable interest in the property. Interestingly, in 2002 the Supreme Court of Connecticut acknowledged the substantial criticism of *Sutton* but concluded nonetheless that based on fairness "the *Sutton* result is sound as a matter of subrogation law and policy". *DiLullo v. Joseph*, 792 A.2d 819, 822 (Conn. 2002).

### Rejection of the *Sutton* Doctrine

Some states have simply rejected the *Sutton* Doctrine and its rationale and have held the exact opposite - that there must be a "clear and unequivocal expression exonerating the tenant from liability from negligent conduct" in order to bar subrogation. *Britton v. Wooten*, 817 S.W.2d 443, 447 (Ky. 1991). In directly refuting the rationale in *Sutton*, the Arkansas Supreme Court wrote that "the fiction by paying the rent, the lessee paid the insurance premium is not appropriate . . . Such a fiction ignores the fact that more often than not the market, i.e. supply and demand, is the controlling factor in fixing and negotiating rents." *Page v. Scott*, 567 S.W.2d 101, 103-104 (Ark. 1978). The states that allow subrogation unless the lease expressly excludes it are Arkansas, Iowa, Kansas, Kentucky, New Jersey and Rhode Island.

### Case-by-Case Analysis - review the express language of the lease

The last line of cases do not follow either hard-line rule. Two recent cases have been handed down that criticize the *Sutton* Doctrine and favor a case-by-case analysis of the lease and any other documents pertinent to the landlord/tenant relationship.

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1. Interestingly, the implied-coinsured doctrine as reasoned in *Sutton* has not been addressed or affirmed by the Oklahoma Supreme Court.

2. An interesting argument raised by the Maryland Court of Appeals in 2005 is that arguably the tenant now has affirmative rights under the landlord's insurance policy - i.e. the right to recover under the policy for damage to the tenant's personal property, and the right to a defense and coverage for claims made by other tenants for damage to their property.
In *Phoenix Insurance Company v. Stamell*, 21 A.D.3d 118 (N.Y. 2005), the insurance carrier for the Colleges of the Seneca sought to recover against a student who left a candle unattended and caused significant damage to a dormitory. The student's carrier argued that under *Sutton* and public policy she was an implied coinsured under Seneca's policy. The court, however, disagreed.

This was a case of first impression to the New York Superior Court. The court stated that New York had never followed a strict implied-coinsured rule such as created in *Sutton* and would not do so in this instance. Rather, the court reviewed the policy of insurance, the "Housing Contract" and the "Handbook for Community Standards" - both of which laid out the provisions and rules for students living in the dorms. First, the court found that the insurance policy did not name students living in the dorms as insureds. Further, the court found that the Housing Contract and Handbook placed responsibility for damages caused due to negligence directly with the students. In particular, the Contract stated that the student "will be responsible for any loss, damage, repair or replacement of the furniture and/or to the building that is beyond normal wear and tear during [the] occupancy of the space." *Id.* at 120. In addition, the Handbook contained a section entitled "Residential Policies" that stated that the college would charge all students who are responsible for causing avoidable damages and losses. "Avoidable damage" was defined as damage that is the consequence of careless, willful, or malicious actions. *Id.* The Residential Policies also informed the students that the college was not responsible for theft or damage to personal belongings. In fact, the Handbook advised the students to obtain personal insurance to cover their personal belongings. Lastly, the Handbook expressly banned candles - "the use of open-flame devices or other burning materials, such as candles and incense, and the melting of wax to fabricate candles, is prohibited." *Id.*

The court found that the Contract and Handbook clearly represented to the student that the student would be responsible for all damages caused by his or her own negligent conduct. The court concluded that there was no way that the student could assume or expect that the College would be purchasing insurance to cover or protect the student from his or her own negligent acts. The court also expressed that the student was insured by a different insurer and "thus, the public policy considerations underlying the antisubrogation rule are inapplicable." *Id.* at 128. Moreover, the court stated that denying Phoenix from recovering from the student would result in a windfall to the student's insurer. *Id.* at 127.

Also in 2005, the Maryland Court of Appeals consolidated two similar cases to address the issue of whether the tenant is an implied coinsured under the landlord's policy. *Rausch v. Allstate Insurance Company*, 882 A.2d 801 (Md. Ct. App. 2005). The Maryland court issued a very detailed analysis and soundly criticized

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3. The student was covered under her parents' homeowners policy.
the flaws in the rationale behind the \textit{Sutton} Doctrine. Like New York, the Maryland court refused to follow a hard line, but rather chose a case-by-case analysis approach. The Maryland court went so far as to state that courts have no business adding insureds to an insurance policy in order to achieve their perception of good public policy. \textit{Id.} at 714. Moreover, subrogation claims against tenants are not inherently against public policy. \textit{Id.} at 715.

The Maryland court stated that the issue must be determined by the express terms of the lease. If the lease relieves the tenant from liability for fire loss, then there can be no subrogation because there is no underlying liability to the landlord. If the lease or by some other commitment the landlord communicated to the tenant that it would maintain fire insurance on the premises, then again, there can be no subrogation. If the leased premises is a multi-unit complex, and absent express terms to the contrary, the court can reasonably assume that the landlord would have in place adequate insurance protecting the entire complex - thus saving the tenant from having to obtain insurance to cover the potential of damage to the entire complex (economic waste argument). The court concluded that "[w]ithin the construct of these principles, a court must look at the lease as a whole, along with any other relevant and admissible evidence, to determine if it was reasonably anticipated by the landlord and the tenant that the tenant would be liable, in the event of a fire loss paid by the landlord's insurer, to a subrogation claim by the insurer." \textit{Id.} at 717.

\textbf{Going Forward - what to look for to determine if you may subrogate against a tenant}

From reviewing the two recent cases, below is a list of terms and provisions in the lease that the court will consider in determining whether the carrier may subrogate against the tenant:

\begin{itemize}
  \item Is there a restriction or limitation of use - i.e. prohibition of open-flames, or storage of combustible/explosive materials;
  \item Express provision that the landlord is not responsible for damage done to tenant's personal property;
  \item Express provision that tenant is responsible to obtain their own separate insurance - either property or personal/general liability;
  \item Express provision that the tenant will indemnify the landlord for all damage caused by tenant;
  \item Express provision that the tenant will return the property in the same or similar condition - accepting for normal wear and tear;
  \item Express provisions that a portion of rent or assessments will go towards covering the landlord's insurance premiums;
\end{itemize}
• Express provisions exonerating or relieving tenant of liability; and
• Express waivers of subrogation.

Other factors the courts will consider are whether this is a commercial versus residential lease, whether it is a single unit versus multi-unit complex, and whether the tenant has separate insurance.4

Conclusion

Although some jurisdictions still adhere to the Sutton Doctrine, in fact a 2005 Tennessee court of appeals decision closely adhered to the rationale in Sutton, other courts have leaned towards a case-by-case analysis and interpretation of the lease terms. More importantly, courts have stressed the need for admissible evidence supporting the parties reasonable expectations regarding the provision of fire insurance when entering into the lease as opposed to the court's ad hoc generalizations about what those expectations are presumed to be. Thus in jurisdictions that allow subrogation against a tenant, you must review the language of the underlying lease and make sure the tenant is not exonerated or has a reasonable expectation that the landlord was providing fire insurance for their mutual benefit.

4. These cases and principles do not apply to the tenant's carrier suing the landlord or suing another tenant that damaged the insured's property. Most jurisdictions do not bar such subrogation claims.
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