A COSTLY SURPRISE

The Presence of a Subrogation Waiver May Change Everything

By Matthew J. Smith, Esq.

Subrogation recovery is never easy for any insurer. This is true for a myriad of reasons, but one of the most frustrating is often one we create, in part, ourselves. There are few things more frustrating to a subrogation professional than realizing you have a large loss with provable negligence and a collectable party and then finding that what otherwise would be a dream case becomes a nightmare with two simple words: subrogation waiver.

Subrogation waivers are not new, having long been a part of insurance policies, nor are they terribly complicated. In their simplest form, these are waivers signed by the insured relinquishing rights to collect from a liable third party for a loss. If you are the liable party on the receiving end of the waiver, you may have cause to celebrate. For many insurers, however, millions of dollars of potential subrogation recovery are lost based upon these agreements.

The vast majority of insurance policies, including those with ISO standard policy language, permit subrogation waivers. Most often these provisions are found in commercial general liability (CGL) policies. Depending upon the policy language, either express or implied, the policy conditions permit an insured to waive recovery against a third party prior to a loss. There is a marked distinction between entering into a waiver of a right of subrogation prior to the loss occurring and entering into such a waiver after the insured is on notice of the loss. Entering into a waiver after the loss has occurred is normally a violation of the policy's terms and conditions granting the insurer the right of subrogation.

While on the surface even a subrogation waiver entered into prior to a loss appears to contradict the subrogation requirement in the policy, such conflicts are routinely resolved against the insurance carrier as the author of the insuring agreement.

While most often found in CGL policies, some commercial automobile insurance policies and commercial property and inland marine policies also may contain conditions granting the right for the insured to waive subrogation provided such a waiver occurs prior to the loss. What remains unclear in many policies is whether the subrogation waiver, even if it occurs prior to the loss, must be in writing. For multiple motives, an insured may claim an oral waiver of subrogation existed prior to the loss even without any documentation or proof. For this reason, many courts are circumspect when it comes to oral waivers of subrogation. Insurers that want to protect themselves fully should make certain their policies afford the opportunity for the insured to waive the right of subrogation only if the waiver occurs prior to the loss and is committed to in writing.

In addition to the world of general liability insurance, most workers' compensation policies also contain waivers of subrogation, further exposing insurers to nonrecoverable risks. While a liability claim may be limited to one occurrence and damages arising therefrom, a workers' compensation claim with a waiver of subrogation may require the compensation carrier to pay an injured party for medical expenses and lost wages incurred for decades into the future.

Waivers of subrogation involving workers' compensation claims also may be problematic, as the waiver may require the employer or the employer's workers' compensation and liability insurers to pay for the employee's injury twice. Depending upon the jurisdiction, a double recovery may be possible where a waiver of subrogation prevents the employer's workers' compensation carrier from subrogating against the third party responsible for the injury. While workers' compensation may be the employee's sole remedy against his employer, the employee may still have a cause of action against the liable party. Depending upon the insuring agreement, if the negligent third party is listed as an additional

insured under the insuring agreement for liability, both the workers' compensation carrier and the liability carrier (perhaps one and the same) may end up paying for the same injury twice. It is important to know whether the state in which the claim arises allows an offset for workers' compensation benefits or whether double recovery is permitted. In many jurisdictions, workers' compensation laws no longer require employees to elect their remedy, and employees may pursue both workers' compensation benefits and a third-party lawsuit simultaneously.

Returning to the world of liability insurance, the most common uses of subrogation waivers involve builder's risk and building construction policies, architecture and design claims, and landlord/tenant liability. Each of these areas presents unique challenges of which insurers must be aware.

Subrogation waivers have long been a common element of builder's risk and building construction policies. The argument was made that, absent subrogation waivers between building owners, contractors, and even subcontractors, the cost for insuring entities during construction would be prohibitive and would hold back new construction economic development. Today, subrogation waivers in these types of policies have become routine and accepted. While an insurer may include a pre-loss subrogation waiver option in the insuring contract, normally the insurer is not involved in the actual negotiation of the terms of the subrogation waiver between its insured and the parties being released from liability. Careful drafting of the subrogation waiver is important if the intention is to limit the waiver to only, for example, a general contractor or construction management company. Like any other contractual provision, the subrogation waiver is going to be strictly construed against the drafting party. A poorly worded subrogation waiver may give rise to unintended third-party beneficiaries, such as subcontractors escaping any liability for thousands, if not millions, of dollars in damage.

One of the most often litigated waivers of subrogation is found in the American Institute of Architects (AIA) A201 General Conditions form. This broadly worded provision literally has shifted the burden of billions of dollars of insurance claims, forcing some insurers to pay and allowing others to escape liability in full. Under this standard AIA clause, both the owner and contractor waive all rights of subrogation against each other and any subcontractors, agents, or employees of each other and against the architect or the architect's consultants for any type of claim or loss to the extent it is covered by property insurance.

Based on this provision, contractors and even subcontractors who normally would bear the risk of loss before a project is completed may completely avoid liability and risk to the extent that the builder's risk or property insurance covers the loss. In essence, this results in a double waiver protecting the contractor or architect from any claims of the owner and also protecting the same entities from any claim of subrogation arising from the insurer's right of subrogation.

While the risk may not be as high as in multistory building construction, subrogation waivers are increasingly a part of lease agreements between landlords and tenants in both residential and commercial settings. The sheer number of leases entered into for everything from office space to warehouses to apartments means insurers across the country may be facing waivers of subrogation in leases they never have the opportunity to review. There are obvious advantages to a landlord requiring the tenant to waive any right of subrogation against the landlord or its agents, subcontractors or the like to the extent of insurance. However, it may come as a surprise to the insurer that honors a claim to find their right of subrogation has been extinguished in what otherwise would have been a fully collectible subrogation recovery.

Across the nation, courts routinely enforce subrogation waiver agreements. It is the rare jurisdiction that will construe a subrogation waiver to benefit the insurance carrier unless the insurance contract specifically prohibits or limits the extent of the subrogation waiver agreement. Once entered into between the insured and the party (or parties) being released, the waiver generally is considered valid.

The extent to which courts will enforce subrogation waiver agreements against insurers has even been extended in some jurisdictions to actions of gross negligence or recklessness by the entity causing the harm or loss. While insurers sometimes have been successful in arguing subrogation waivers that attempt to void claims for intentional acts, gross

negligence or reckless and willful misconduct should be void against public policy, though certain jurisdictions will force the insurer to pay the claim and forego the right of subrogation. In the view of many judges, the insurance company has control of its own policy language, and if the intent was to permit a subrogation waiver only for mere negligence and prohibit waivers involving more egregious actions, then the policy should contain such a provision.

For insurers still seeking subrogation recovery, all hope is not lost, and this is especially true in today's new economy. One of the advantages to insurance contracts not changing quickly over time and subrogation waivers having been around for many years is that the provisions generally have not kept up with the changing nature of employment.

While a subrogation waiver may apply to a contractor or even subcontractor, a thorough investigation of the claim should be made to determine whether the actual person or entity causing the loss was acting as an independent contractor, was retained through an employment or staffing company or agency, or perhaps was even operating through a day labor pool. Such "phantom employers" might not be included within the scope of the waiver of subrogation and accordingly may be collectible either personally or through applicable liability insurance.

Especially if the subrogation waiver provision of the insurance contract requires a written agreement, it certainly is reasonable to request any party claiming protection under a waiver of subrogation to provide the written documentation proving that they fall within the ambit of the subrogation waiver in accordance with the policy terms and conditions. This may be crucial, especially when the original agreement was entered into between the releasing party and a contractor or architect and one or more subcontractors are now claiming that they are third-party beneficiaries of the subrogation waiver agreement.

Even assuming all parties are included on the subrogation waiver, all hope for recovery might not be lost. A thorough investigation done by the subrogated insurance company also should consider whether nonreleased parties under the waiver may bear liability for the occurrence of the loss and damage based upon theories, including failure to warn of dangers and risk, intentional or negligent concealment of information, product defect or product liability claims, and even allegations of contributory negligence. Depending on the jurisdiction in which the claim arose, even a small percentage of liability on a responsible party not covered under the subrogation waiver could allow the insurance carrier to recover a substantial amount or even all of the damages paid.

There is a high probability that subrogation waivers will be a part of the insurance lexicon a century or more from now. The same problems being addressed today will be occurring then. The key factors for insurers to consider in dealing with subrogation waivers are to be aware of their existence and to understand the extent to which your policy grants the insured the right to enter into such a waiver. Insurers should be cognizant of whether the insured is required to disclose and seek approval from the insurance carrier for a waiver of subrogation and should always verify whether the waiver was entered into before or after the loss occurred.

Perhaps most importantly for insurers seeking subrogation recovery is to find out early on in the claim investigation process whether a valid subrogation waiver exists. There is simply nothing worse than devoting thousands of dollars to the investigation and even litigation of a collectible subrogation recovery matter only to find out months or years later that a subrogation waiver voids any right of recovery.

As with most other aspects of insurance, subrogation waivers are not overly complicated. As in sports and courts, there always will be winners and losers. Depending on which side of the "subrogation waiver ball" you are on, your insurance company may be the beneficiary or responsible for paying a claim with no right of recovery. CM

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