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Subrogation Claims and Arbitration Clauses in Construction Contracts

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In Texas, while an insurer can assert a subrogation claim independently of its insured, the insurer still stands in the shoes of its insured, meaning the insurer's claims are limited to those the insured could bring and are subject to the same defenses. A common defense when a loss involves a construction project is that subrogation has been waived in the construction contract. The application and enforceability of a waiver of subrogation clause depends on the specific contract language, but common industry waivers (such as the standard AIA waiver of subrogation clause) are generally upheld and enforced under Texas law to preclude insurers' subrogation claims. It makes sense then that a subrogated insurer pursuing a claim against a contractor could also be subject to any dispute resolution provisions agreed to by its insured in the construction contract, including arbitration clauses.

The Thirteenth Court of Appeals, which serves the Corpus Christi and Edinburg area of Texas, recently issued a memorandum opinion addressing this exact issue – whether a subrogated insurer is bound by an arbitration clause in a construction contract between the insured and the party responsible for a loss. *Roland's Roofing Co., Inc. v. Nationwide Mut. Ins. Co.*, 13-19-00580-CV, 2020 WL 3478658 (Tex. App.—Corpus Christi June 25, 2020, no pet. h.).

As set forth in the opinion, Nationwide Mutual Insurance Company insured Haidar Properties, LLC, which operated an IHOP restaurant in McAllen, Texas. After a hailstorm severely damaged the restaurant's metal roof, Haidar contracted with Roland's Roofing Company, Inc. to replace the roof. While the roof was being replaced, the restaurant manager discovered a fire in a second-floor equipment room. The local fire department determined that heat produced from a halogen light mounted to the exterior roof, which faced the roof's wooden decking, ignited the decking and caused the fire. Haidar submitted a claim to Nationwide for the damages caused by the fire, and Nationwide filed a subrogation action against Roland's Roofing and others to recover its payments to Haidar.

About eleven months after Nationwide filed suit, Roland's Roofing filed a motion to compel arbitration. The contract between Haidar and Roland's Roofing included an arbitration clause that required "[a]ny controversy or claim arising out of or relating to this Agreement or breach thereof [to] be settled by arbitration binding on both parties in accordance with the Federal Arbitration Act (FAA) and the Construction Industry Arbitration Rules of the American Arbitration Association." After more than a year of procedural wrangling, the trial court denied Roland's Roofing's motion to compel arbitration. Roland's Roofing appealed that decision.

On appeal, one of Nationwide's arguments was that it should not be compelled to arbitrate its subrogation claim against Roland's Roofing because it was not a signatory to the contract that included the arbitration clause. In rejecting this argument, the appellate court relied on Texas case law stating that a subrogated insurer stands in the shoes of its insured and the "insurer's right to subrogation derives from the right of the insured, and is limited to those rights."

Arbitration clauses commonly appear in construction contracts; and, as noted by the court in *Roland's Roofing*, "Texas policy and federal policy favor arbitration." In practice, this means that generally any doubts concerning the scope of an

arbitration agreement will be resolved in favor of arbitration.

While the pros and cons of arbitration over litigation can be debated, arbitration is often touted as being less expensive than litigation, which is not always the case. Depending on the forum and the amount of the claim, the filing fee for arbitration can be significantly more than the filing fee in litigation. Additionally, parties typically pay for the time of an arbitrator that presides over the arbitration in a proceeding administered by the American Arbitration Association (AAA) or similar organization. In contrast, parties do not have to pay for a judge's time, and jury fees are often nominal. If a panel of three arbitrators will hear and decide a case, the costs can increase exponentially. In fact, the AAA notes on its website that a three-arbitrator panel can actually cost five times as much as a single arbitrator. These additional costs could substantially impact the net recovery in a subrogation case.

When a loss involves a construction project, early identification of the proper forum in which to bring a subrogation claim – litigation or arbitration – could save considerable time and expense. The parties in *Roland's Roofing* incurred two years of costs in litigation before being ordered to arbitration, which likely compounded the overall costs incurred.

Subrogation professionals know the importance of looking for and analyzing the impact of a waiver of subrogation clause in a construction contract. The *Roland's Roofing* case highlights the importance of also looking for and analyzing the impact of any arbitration clause or other dispute resolution provision that may be included in the contract. If the construction contract contains an arbitration clause but litigation is preferred, the parties can always agree to litigate rather than arbitrate.

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