

## Waiver of Subrogation Provisions in Construction Contracts - Part Two

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In **Part One**, I discussed the general purpose and benefits of subrogation and considerations in determining whether a waiver of subrogation may be advantageous or harmful to certain contracting parties to a construction contract. Even where the contracting parties agree to include a waiver of subrogation, a form waiver of subrogation may not be appropriate in a given situation. For example, the form waiver contained in the American Institute of Architects (AIA) Document A201, General Conditions of the Contract for Construction, is one of the most commonly used form provisions in construction contracts and is also probably one of the most litigated. As a result, modifications to form provisions are often warranted, or contracting parties are free to draft and define the scope of a waiver of subrogation provision as they see fit for their project.

In drafting or evaluating the scope of a waiver of subrogation provision, the following issues should be analyzed:

- **Whether the waiver extends to post-completion losses.** While it may make sense to have a broad form waiver provision in effect during construction to avoid disruption and preserve other economic efficiencies, that same rationale may not apply to post-completion losses. After completion, the owner is typically the only party left with an insurable interest in the property, and it may no longer be practical for the owner and its insurer to continue to bear the risk that the work performed by third parties was not completed in a good and workmanlike manner or in accordance with applicable codes. A waiver that applies to post-completion losses can also prejudice the owner in at least two specific ways: (1) as discussed in Part One, such a loss could be reported without a subrogation recovery on the owner's loss history and result in future increased premiums; and (2) the owner could be responsible for and not have the ability to recover any applicable deductible or self-insured retention from the party responsible for causing the loss.

The issue of whether a given waiver precludes subrogation claims for losses that occur after completion has been frequently litigated and discussed in case law across the country. When a contract includes a subrogation continuation clause like the one found in Section 11.3.2 of AIA Document A201-2017,<sup>1</sup> courts generally extend subrogation waivers to post-completion losses. On the other hand, when a subrogation continuation clause is not included in the construction contract, courts have been more willing to limit the temporal scope of subrogation waivers to losses that occur during construction. As a result, owners should consider the potential implications of agreeing to a subrogation continuation clause and of obtaining additional insurance coverages or separate policies beyond those specifically covering the project during construction, not only in terms of their out-of-pocket exposure but also on the cost of future insurability.

- **Whether the waiver applies only to the property insurance policy specifically required by the parties' agreement rather than to other property insurance applicable to the work or project / Whether the waiver precludes claims for damage to non-work property.** Another issue that has been frequently litigated is whether a waiver provision precludes subrogation claims for damage to non-work property, such as damage to pre-existing parts

of a building when a fire occurs during a renovation project or damage to the owner's personal property stored within the building. Many courts disagree on the scope of the standard AIA Document-A201 form waiver of subrogation provision in this regard.

One view, which is followed in Texas, is that the scope of the waiver is based on whether the owner's insurance policy provides coverage for losses arising from damage to the property. This approach focuses on the extent and source of coverage and is referred to as the "any insurance" or "source of coverage" approach. Under the "any insurance" approach, courts have found that the owner waives subrogation for all losses covered by the owner's insurance policy "applicable to the Work," regardless of whether the damage was to work or non-work property.

The other view looks at whether the injury is to "Work" or "non-Work" property. Courts in jurisdictions that have adopted this view focus on the nature of the property damaged and it is predictably called the "Work versus non-Work" or "type of damages" approach. Under the "Work versus non-Work" approach, the owner waives subrogation only for losses related to the "Work" – i.e., the contracted-for construction and services.

- **Whether the waiver precludes claims against subcontractors, suppliers and manufacturers.** When drafting or modifying a form waiver of subrogation provision, it is also important to consider what parties should be covered by the provision. It may not be beneficial for an owner to include all subcontractors, sub-subcontractors, or equipment and material suppliers and manufacturers within the scope of the waiver, especially if the waiver extends to losses that occur post-completion.
- **Whether the waiver applies to claims against design professionals for damages arising out of the provision of professional services.** Broad form waiver provisions will typically extend to these types of claims, while the builder's risk policy for the project may not allow for a waiver of these claims. Unnecessary disagreements or litigation can be avoided if policies and waiver provisions are consistent from the beginning of the project.
- **Whether the waiver applies to liability insurance policies.** Many broad form waiver provisions apply to "property insurance required by the Agreement" or "other property insurance applicable to the Work." If a liability insurer pays to settle a property damage claim because its insured is legally obligated by contract to pay the claimant and the liability insurer pursues a subrogation claim against a third party determined to be primarily liable for the damage, an issue can arise regarding the viability of the subrogation claim – does liability insurance constitute "property insurance required by the Agreement" or "other property insurance applicable to the Work"?
- **Whether the waiver precludes claims for deductibles or self-insured retentions.** As noted above in the discussion of post-completion losses, this can cause the owner to bear out-of-pocket costs that cannot be recovered from the wrongdoer.
- **Whether the waiver precludes claims for damages caused by a party's gross negligence or violation of applicable codes.** Waivers are generally enforced to preclude covered losses caused by ordinary negligence. When the conduct of the party responsible for causing the loss rises above ordinary negligence – when the claim is based on gross negligence, willful misconduct, or violation of applicable codes, questions can arise as to whether a subrogation waiver should be enforced. Question can also arise as to whether a waiver precludes a subrogation claim when the party responsible for causing the loss breaches the contract or breaches a duty outside of the contract.
- **Whether the waiver is contingent on the parties obtaining waivers from their subcontractors or consultants or on any other contractual undertaking.**

These issues can all be addressed with careful drafting. While courts can vary on their interpretations of form contract language, courts should generally enforce clear and specific language.

Review and revision of broad form waiver of subrogation provisions can help ensure that the contracting parties effectively allocate risks to the intended parties and insurers during construction and post-completion. If a waiver of subrogation provision is modified in a form contract, it is important to consider the implications the modification may have on other provisions in the contract documents and other agreements or policies applicable to the project. When modifying a form waiver provision, it may be necessary to modify other provisions to ensure that the intent of the modification is consistent throughout the agreement and across all applicable documents.

<sup>1</sup> § 11.3.2 If during the Project construction period the Owner insures properties, real or personal or both, at or adjacent to the site by property insurance under policies separate from those insuring the Project, or if after final payment property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period, to the extent permissible by such policies, the Owner waives all rights in accordance with the terms of Section 11.3.1 for damages caused by fire or other causes of loss covered by this separate property insurance.

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