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Understanding Waiver of Subrogation Clauses

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Waiver-of-subrogation clauses are an important risk-allocation tool included in nearly every sophisticated construction contract. Because of the prevailing economic conditions and business interests at stake, all those involved in a construction project have a heightened interest in understanding these clauses. The parties to such a clause agree to "waive" the right of their insurer to file a subrogation claim after paying for a loss. The public policy accepted by many courts acts to prevent divisiveness among parties with ongoing commercial relationships and promote economic efficiency because only one party needs to insure the risk. See Britell, Staville, Ono, *Waivers of Subrogation in a Nutshell*, 235 N.Y.L.J. 9, 10-11 (2006). However, this risk shifting policy is only realized where the waiver itself prevents litigation.

In recent years, waiver-of-subrogation clauses have done little to prevent litigation. The disputes generally arise between the owner's property insurer and the contractors involved in the original construction in response to post-construction events, including fire, flood or other property damage. The insurer who reimbursed the owner for the loss may argue that the clause is limited to claims made during the construction project. The contractors, architects, etc., argue that the waiver extends to claims made after the completion of the project.

Courts generally uphold waiver of subrogation clauses and dismiss subrogation claims where the clause clearly applies to claims made after the construction project is complete. In some circumstances, the clauses may not be crystal clear. Courts that have interpreted these clauses have done so in light of other clauses in the standard AIA contract, including the completed project insurance clause and the definition of "the Work."

The Waiver of Subrogation Clause

A typical AIA version of the clause reads:

The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other . . . for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to Paragraph [X] or other property insurance applicable to the Work . . ."

Under the plain meaning of the clause, subrogation claims are waived (1) where property insurance was required by the general contract, or (2) where there is other property insurance applicable to "the Work."

The Completed Project Insurance Clause

If the property insurance at issue was required by the contract, the court will likely apply the waiver and dismiss the case. The clearest contracts contain a "completed project insurance clause" to address the issue. In the recent case of *MiddleOak Ins. Co. v. Tri-State Sprinkler Corp.*, 77 Mass. App. Ct. 336 (2010), for example, the Massachusetts Appeals Court upheld a waiver where the completed project insurance clause clarified that the parties intended the waiver to apply to post-construction losses. The *MiddleOak* Court affirmed the dismissal of a \$5,000,000.00 subrogation claim. The completed project insurance clause, which was from an AIA form, stated the following:

If during the Project construction period the Owner insures properties . . . 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, the Owner shall waive all rights in accordance with the terms of [the waiver of subrogation clause] for damages caused by fire or other causes of loss covered by this separate property insurance."

By contrast, in *John L. Mattingly Constr. Co. v. Hartford Underwriters Ins. Co.*, 415 Md. 313 (2010), the Court of Appeals of Maryland refused to apply a waiver where there was no completed project insurance clause. The Court explained that the "majority" of jurisdictions that uphold waivers have done so in the context of completed project insurance clauses. The Court held that, without such a clause, the waiver of subrogation clause was ambiguous and reversed the entry of summary judgment on the \$1,000,000.00 claim.

At least one court has held that the completed project insurance clause was insufficient to expand the waiver to post-construction losses. In *Lumbermens Mut. Cas. Co. v. Grinnell Corp.*, 477 F.Supp.2d 327 (D. Mass. 2007), the court explained that the phrase "to be provided" applied only where the parties agreed in advance to provide such insurance. This holding appears to be a minority position and was explicitly rejected as "too crabbed a reading" by the Massachusetts Appeals Court in *MiddleOak*.

The Work

Where property insurance is not required by the contract, the question becomes whether post-construction insurance constitutes "other property insurance applicable to the Work." The analysis depends on whether the Work includes the completed project. The term "work" in the AIA forms is generally defined as follows:

[C]onstruction and services required by the Contract Documents *whether completed or partially completed*, and includes all other labor, materials, equipment and services provided or to be provided by the Contractor to fulfill the Contractor's obligations. The Work may constitute the whole or a part of the Project.

In *MiddleOak* Court relied on this provision as evidence that the parties intended to extend the waiver to post-construction losses. However, the court in *John L. Mattingly Constr. Co.*, held that the provision could be plausibly interpreted to apply either (1) to the construction phase only, or (2) to both the construction and post-construction phase. The Court, therefore, deemed the provision ambiguous and remanded the case to the trial court for further evidence of the parties' intent.

Conclusion

The waiver of subrogation clause has seen significant litigation in recent years in the context of post-construction losses. Whether the waiver will bar subrogation claims in post-construction losses depends largely on the text of the clause in light of the completed project insurance clause, if one exists, or the definition of the "work" in the contract. The standard language contained in the AIA forms leaves room for interpretation.

The importance of the waiver is immeasurable when carefully drafted. Construction professionals and transactional lawyers should consider amending the forms to ensure the intent of the parties is properly memorialized. Property insurers should fully investigate waivers agreed to during the construction phase and assess the risk accordingly. Only then will such clauses prevent litigation and fulfill their purpose to prevent divisiveness among parties and promote economic efficiency.

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