

The Waiver of Subrogation Clause

Many of the AIA documents contain a waiver of subrogation provision. Such a term is important because it prevents an insurance company that has paid out for a loss from suing another party involved with the project. In AIA Document A201, the General Conditions of the Contract for Construction, 1997 edition, the following language is used:

11.4.7 Waivers of Subrogation. 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, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Paragraph 11.4 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

In the B141-1997, Owner-Architect Agreement, the following language is used:

1.3.7.4 To the extent damages are covered by property insurance during construction, the Owner and the Architect waive all rights against each other and against the contractors, consultants, agents and employees of the other for damages, except such rights as they may have to the proceeds of such insurance as set forth in the edition of AIA Document A201, General Conditions of the Contract for Construction, current as of the date of

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this Agreement. The Owner and Architect, as appropriate, shall require of the contractors, consultants, agents and employees of any of them similar waivers in favor of the other parties enumerated herein.

Take, for example, a situation where a worker on the project sparks a fire that causes damage. The insurance company pays to repair the work and then wants to be reimbursed for its payments. Theoretically, the owner and contractor have had their losses covered and the only party with a loss in this case is the insurance company (assuming there were no deductibles or other losses not covered by insurance). Without a waiver of subrogation, the insurance company sues the worker, the worker's employer, possibly the architect, and anyone else that it can find. The insurance company can sue these people because it steps into the shoes of its insured – it is subrogated. Anticipating the possibility of such an event, each party should charge a slightly higher rate to take this risk into account. The owner thus pays not only for the insurance but also the additional risk for each party.

When the contract contains a *waiver* of subrogation, the insurance company cannot step into the shoes of its insured and, therefore, cannot sue any party to which the waiver is effective. This is exactly what was intended, since by buying insurance for a construction project, the parties usually do not intend to be sued by that insurance company. That is the reason for the insurance in the first place, to have the insurance company take the risk of loss and not pass it on to the project team.

In a recent Illinois case,¹ a village's property insurer sued the architect after it had paid for a loss caused by a fire. Because of a waiver of subrogation provision in the owner-architect agreement, apparently from an AIA agreement, the case was dismissed at the outset. The court rejected the argument that this provision acts to indemnify a party for that party's negligence, saying that the insurance clause (the waiver of subrogation) shifts the risk of loss to the insurance company regardless of which party is at fault. It also does not limit a third party's right to sue, since such a provision is only a risk allocation provision.

Notice that the language quoted above is limited to property insurance. What if a loss is covered by something other than a property insurance policy. For instance, Zurich offers a policy to contractors called "Subguard" that protects the contractor from defaults by its subcontractors. This is not considered property insurance, but there could be situations where the policy pays out and the insurance

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carrier will seek to cover its losses by filing suit against the parties that might have contributed to the loss. Many other types of insurance might also not be considered property insurance and therefore not covered by the waiver of subrogation clause. This is true even if the covered loss is limited to property or economic damages.

One thing that can be easily done is to expand the language of Paragraph 11.4.7. Replace the words “property insurance” with “any form of insurance, suretyship or policy of indemnification.” This broadens the scope of this provision to include other types of insurance coverages. Make sure that other contracts, including the owner-architect agreement reflect these changes. Many states permit contractors and others to sue the architect and engineer directly for the types of damages covered by these insurance policies. This means that an insurance company or surety can do likewise.

As always, it is important to consult with persons knowledgeable in the subject. An experienced insurance advisor as well as a construction attorney familiar with the jurisdiction where the project is located can offer invaluable advice. Even if you cannot eliminate the risk, you should at least be aware that there is risk so you can minimize it as well as being properly compensated for the level of risk involved.

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1. *Intergovernmental Risk Management v. O'Donnell, Wicklund, Pigozzi*, 692 N.E.2d 729 (1st Dist. 1998)

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