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The Waiver of Subrogation Clause - Litigation Update

In a recent Delaware case involving the construction of a nursing home, water chillers being installed started to leak. Water damage caused by the leak resulted in more than \$50,000 in damage to the Work and adjacent structures. After the insurance carrier paid out, litigation ensued over who would pay for the damages because the carrier wanted the responsible contractors to reimburse it for the damages it had incurred. The contracts in question incorporated the 1987 version of AIA Document A201, the General Conditions of the Contract for Construction, which is similar to the 1997 version in regards to the waiver of subrogation provisions which are the focus of this article.

Here is the relevant language from the 1997 version of A201:

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.

This waiver extends to property other than the Work under the con-

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tract if that property damage is covered by other property insurance held by the owner under this provision of A201:

11.4.5 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, the Owner shall waive all rights in accordance with the terms of Subparagraph 11.4.7 for damages caused by fire or other causes of loss covered by this separate property insurance. All separate policies shall provide this waiver of subrogation by endorsement or otherwise.

The idea behind these provisions is as follows: by buying insurance for a construction project, the parties usually do not intend to be sued by the 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. By including a waiver of subrogation clause in the contract, the insurance company is prevented from stepping into the shoes of its insured and, therefore, cannot sue any party to which the waiver is effective.

In this case, the insurance carrier attempted to avoid the effect of the waiver of subrogation provision by making several arguments. First, it urged the court to find the provision void as being against public policy. This was premised on a Delaware statute holding that any construction contract provision that purports to indemnify a party against its own negligence is void and unenforceable. The court rejected this argument on the basis of prior court rulings in Delaware that rejected this interpretation. The court also reviewed cases in both state and federal courts which found that standardized waiver of subrogation provisions found in commonly used contracts, such as this one, are routinely upheld.

Among the reasons cited by various courts are that such “clauses seek to avoid the prospect of extended litigation which would interfere with construction by shifting the risk of loss to the insurance company regardless of which party is at fault”; such clauses are “useful in construction projects because they avoid disruption and disputes among the parties to the project by eliminating the need for lawsuits and protecting contracting parties from loss by bringing all property damage under builder’s all-risk property insurance”; and “because the insurer presumably has considered the risk of loss in establishing its premiums, the insurer should not have the ability to recoup that loss by subrogation against the other parties

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allegedly causing the loss”. A final reason was that “public policy considerations also favor these types of agreements which avoid higher overall costs resulting from the multiplicity of insurance policies and overlapping coverage.”

The second argument of the insurance carrier was that it had not been notified of the waiver provision. Because this provision is common and standard in the industry and is one with which the insurance companies would be commonly familiar, this argument was unpersuasive with the court.

The final argument of the insurance carrier was that the loss included “non-work” areas. This argument was rejected on the basis of paragraph 11.4.5, which specifically addresses this issue. This paragraph essentially states that if property adjoining or adjacent to the site is insured by property insurance by the owner, then the waiver of subrogation is also effective as to such adjacent areas covered by insurance.

Waiver of subrogation provisions are found in AIA contracts and many other construction agreements. They protect the various parties involved in construction and should not be altered or removed except for good reason and after professional consultation.

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