

Waiver of Subrogation Clauses and the Effect of Collateral Coverage Litigation

Wednesday, June 17, 2015

Presented By the IADC Construction Law and Litigation Committee and Insurance and Reinsurance Committee

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Topics for Review

- Waiver of subrogation provisions.
- Scope of waiver of subrogation.
- Applying waiver of subrogation provisions in real-world construction contract scenarios, in the context of collateral litigation.

What is subrogation?

- In the context of insurance:
 - An insurer's substitution in place of the insured regarding a claim against a third party for indemnification of a loss paid by the insurer.

Why waive subrogation?

- Parties involved in construction contracts will often waive rights of recovery against each other.
- Insurance policies typically recognize a written subrogation waiver issued prior to a loss.
- Avoid a battle of insurance companies.
- Prevent construction shutting down.

Common Waiver of Subrogation Clause (AIA Contract)

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....

Insurer consent to subrogation waiver?

- Usually, a waiver of subrogation clause bars an insurer's subrogation claim where the insured had waived its subrogation rights in a construction contract.
 - The insurer has no greater rights than those possessed by the insured.
- *But, see Ace Fire v. Miron Const.*, 2002 Wisc. App. Lexis 829 (July 17, 2002) (unreported) (holding that the reservation of subrogation rights provision in an insurance policy reserved the insurer's rights without limitation).

Insurer consent to subrogation waiver?

- Builder's risk policies typically provide that an insured may not do anything to impair the insurer's right of recovery after paying a loss without the insurer's consent.
- The policies usually provide that an insured may waive such rights in a written pre-loss contract.

Insurer consent to subrogation waiver?

- Tips:
 - If the construction contract requires a waiver of subrogation, does the contract comport with the insurer's terms and conditions?
 - Avoid creating grounds for the insurer to deny coverage.

Scope of Subrogation Waiver

- Determining the scope of a subrogation waiver can raise complex issues.
- Courts often begin by evaluating the contractual allocation of insurance responsibilities.

Scope of Subrogation Waiver

- The Owner is usually required to obtain builder's risk property insurance.
 - “Unless otherwise provided the Owner shall purchase and maintain, in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located, property insurance written on a **builder's risk “all-risk” or equivalent policy** form in the amount of the initial Contract Sum, plus value of subsequent Contract Modifications and cost of materials supplied or installed by others, comprising total value for the entire Project at the site on a replacement cost basis without optional deductibles. Such property insurance shall be maintained, unless otherwise provided in the Contract Documents or otherwise agreed in writing by all persons and entities who are beneficiaries of such insurance, until final payment has been made as provided in Section 9.10 or until no person or entity other than the Owner has an insurable interest in the property required by this Section 11.3 to be covered, whichever is later. **This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.**” (A201-2007, Section 11.3.1)

Scope of Subrogation Waiver

- The contractor is usually required to obtain liability insurance.
 - “The Contractor shall purchase from and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor’s operations and completed operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable....” (A201-2007, Section 11.1.1)

Scope of Subrogation Waiver

- Waiver of subrogation provision apply to subcontractors?
 - A subcontractor is an insured because the Owner was required to purchase insurance to protect of the interests of “the Owner, the Contractor, *Subcontractors and Sub-subcontractors* in the Project.”

What does the waiver cover?

- Definition of “Work”
 - “The term ‘Work’ means the construction 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.” (A201-2007, Section 1.1.3)
- Definition of “Project”
 - The Project is the total construction of which the Work performed under the Contract Documents may be the whole or a part and which may include construction by the Owner and by separate contractors.” (A201-2007, Section 1.1.4)

How long does the waiver last?

- Generally, the waiver only covers losses during construction.
- The insurance coverage must cover losses “until final payment has been made ... or until no person or entity other than the Owner has an insurable interest in the property.” (A201-2007, Section 11.3.1)

How long does the waiver last?

- Exception:
 - Does the contract contain a subrogation continuation clause to extend the waiver to post-construction losses?
 - “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 Section 11.3.7 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.” (A201-2007, Section 11.3.5)

Complexities of Applying the Waiver Provision

- **Construction Contract Scenario #1**
 - Contractor allegedly causes a loss.
 - Owner makes a claim on the builder's risk policy.
 - Builder's risk insurer covers the claim.
 - What now?
 - Can the insurer pursue a subrogation action against the contractor?
 - Claim barred by waiver of subrogation provision.

- **Construction Contract Scenario #2**
 - Contractor allegedly causes a loss.
 - Builder's risk insurer takes the position that the loss is excluded due to faulty workmanship.
 - Owner sues the general contractor.
 - What now?
 - Contractor wants the benefit of the subrogation waiver.
 - But, coverage is disputed. Need to establish coverage.
 - Bring the insurer into the litigation?

- **Construction Contract Scenario #3**

- Contractor allegedly causes a loss.
- Builder's risk insurer takes the position that the loss is excluded due to faulty workmanship.
- Owner sues builder's risk insurer.
- The insurer, while still denying the claim, settles with the owner for some, but not all, of the damages for the loss.
- What now?
 - Can the owner sue the contractor for the difference?
 - Contractor, wanting the benefit of the waiver provision, will need to establish coverage.
 - No authority for position that settling a disputed claim is the equivalent of admitting coverage.
 - Coverage remains in dispute.

- **Construction Contract Scenario #4**
 - Contractor allegedly causes a loss.
 - Builder's risk insurer takes the position that the loss is excluded due to faulty workmanship.
 - Owner sues builder's risk insurer.
 - Concurrently, in separate litigation, the owner sues the general contractor.
 - What now?
 - Is it preferable to decide factual issues about the loss in the coverage lawsuit or in the contractor lawsuit?
 - Should one case be stayed in favor of the other?

- Construction Contract Scenario #4 (part 2)
 - Contractor allegedly causes a loss.
 - Builder's risk insurer takes the position that the loss is excluded due to faulty workmanship.
 - Owner sues builder's risk insurer.
 - Concurrently, in separate litigation, the owner sues the general contractor.
 - What now?
 - If both cases proceed in parallel, would findings by one court be binding against the other?
 - Different parties in both suits.
 - Could the contractor be adversely affected by a ruling in the coverage lawsuit?
 - Likely no *res judicata*.

- **Construction Contract Scenario #4 (part 3)**
 - Contractor allegedly causes a loss.
 - Builder's risk insurer takes the position that the loss is excluded due to faulty workmanship.
 - Owner sues builder's risk insurer.
 - Concurrently, in separate litigation, the owner sues the general contractor.
 - What now?
 - Should, or *must*, both cases be joined?
 - Get all issues heard by the same jury.

Joinder in the Context of Declaratory Judgment Actions

- Federal: 28 U.S. Code, Section 2201
 - “Creation of remedy. (a) In a case of actual controversy within its jurisdiction... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought....”
- In some States, joinder of necessary parties in a declaratory judgment action is *required*, not simply permissive.
 - Maryland Uniform Declaratory Judgment Act requires that anyone “who has or claims an interest which would be affected by the declaration, shall be made a party.” Maryland Code, Courts and Judicial Proceedings, Section 3-405(a)(1).

- **Construction Contract Scenario #5**

- Subcontractor allegedly causes a loss.
- The builder's risk carrier, the general contractor's general liability carrier, and the subcontractor's general liability carrier each deny coverage, claiming that the loss is excluded due to faulty workmanship.
- The general contractor, claiming to be an additional insured under the subcontractor's general liability policy, sues the subcontractor and the subcontractor's general liability carrier.
- The subcontractor's general liability policy has an excess clause for additional insureds.
- What now?
 - Subcontractor may want the benefit of a waiver provision in the subcontractor's contract with the contractor.
 - Coverage is disputed under all three policies.
 - Threat of piecemeal litigation?
 - Benefit of joining the other carriers.

Questions for Presenters?



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