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Waivers of Subrogation: What are they, and why should I care?



What is subrogation?

What is a waiver of subrogation and why do we have it?

Waiver of subrogation explained

How waivers work in the construction world

What is the downside of a waiver?

Not all insurance carriers are alike

Tips for negotiating a waiver of subrogation

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Waivers of Subrogation: What are they and why should I care?

What is subrogation?

When an insurance company pays for a loss, and someone other than its insured might be to blame, the insurance company can sue those responsible to recover the financial losses it paid on the insured's behalf. The term *subrogation* means that the insurance company is stepping into the shoes of its insured, and suing the responsible parties as if it were the insured filing suit directly. (Note that an insurance company cannot pursue subrogation against its own insured.)

What is a waiver of subrogation and why do we have it?

When insurance companies start suing to get money back, this often results in cross-claims among parties, and fights over who did what wrong. While subrogation disputes during construction are less common, they can not only sour relationships among design and construction team members and owners, but they can also be expensive. This type of litigation can slow the progress of construction, complicating the project or causing the owner to terminate its relationship with the design professional.

Instead, parties can agree up front in their contracts that if there is a loss, and the loss is paid by insurance, the insurance company cannot pursue recovery through the process of subrogation from any party. This contractual mechanism is referred to as a *waiver of subrogation*; as a result, the insurer's rights are effectively waived by the policyholder.

Waiver of subrogation explained

A waiver of subrogation means that the carrier who pays the loss cannot turn around and file a lawsuit for reimbursement against the party who caused the loss.¹ For example, in a situation where a builder's risk insurer pays for a loss quickly to minimize the impact on the critical path of a construction project, a design firm might be insulated from liability through a waiver of subrogation.

In the builder's risk scenario, consider the following example: An elevated walkway at a new commercial building collapses during construction, possibly due in part to negligent design. Typically, a contractor² would purchase a builder's risk insurance policy to cover certain losses that result in property damage during construction.

Assuming the loss was covered, the builder's risk carrier might investigate the loss, pay the claim, and then file a lawsuit against the design team whose negligence may have caused or contributed to the collapse, provided that damages from the design defect were too difficult to determine in order to exclude coverage in the first place.³ In this case, the builder's risk carrier is subrogated to the rights of the contractor, and steps into the shoes of the contractor when filing the lawsuit. If the contracts contain waivers of subrogation, the builder's risk insurer cannot sue the design professional.

Other types of insurance may pay losses after the project is completed and those insurance companies may also have subrogation claims against design firms. Some additional types of insurance that would typically cover damage to the building and its contents and trigger potential subrogation actions against design professionals include:

- first party property insurance typically purchased by the owner and/or tenant;⁴
- general liability insurance purchased by the general contractor and other construction trades; and
- professional liability insurance purchased by the other design professionals for negligent errors or omissions in performing professional services that result in damage to the building.

As with the example above, if the contracts contain waivers of subrogation, then these insurers cannot file suit against the other members of the design and construction team to recover their losses.

How waivers work in the construction world

On a standard design-bid-build project, the owner usually will have a waiver of subrogation in the contract with the prime design firm as well as with the general contractor. That provision typically will also require that any subconsultants and subcontractors agree to this provision in their contracts. To accomplish the goal of transferring risk to the builder's risk carrier and no one else, it is vital that all of the design and construction teams have waivers of subrogation in their contracts.

¹ An aggrieved party can still file suit against the design professional and contractors to collect damages that were not fully reimbursed or covered by the insurer, like a deductible. However, a defendant is not subject to double recovery for the same loss. The carrier may recover amounts it paid in a subrogation action, and an aggrieved party may sue to recover damages for amounts the carrier did not pay.

² There are many different builder's risk products on the market that can be purchased by contractors or owners and vary in the damages they cover, the valuation methods used to pay losses, and the entities afforded coverage. XL Catlin is a leading provider of builder's risk policies and offers coverage to national and multinational companies for public and private infrastructure projects. For more information, please visit: <http://xlcatlin.com/insurance/insurance-coverage/casualty-insurance/builders-risk>

³ Most builder's risk policies in the U.S. exclude defective design, workmanship and materials. The scope of the exclusions range from total exclusions to exclusions that provide coverage for resultant or ensuing losses.

⁴ Property insurance typically excludes defective design and faulty construction, and is triggered by a catastrophic event like wind or fire.

The scope of these waivers can vary greatly. The key distinctions are:

- whether the waiver applies to all insurance or exclusively to builder's risk or first party property insurance; and
- whether the waiver applies to losses during construction or to losses that take place after the project is completed.

These distinctions can have a critical impact on a design firm's exposure to claims arising after a project is completed, like a structural failure resulting in a walkway collapse.

What is the downside of a waiver of subrogation?

Occasionally, a waiver of subrogation can be a problem if your insurance is called upon to pay a loss and others are partially to blame. As mentioned above, if there is a waiver of subrogation, your insurance company cannot recoup any of the loss dollars it pays due to the fault of others. For example, it is possible that your carrier is compelled to act quickly and pay to remedy a design defect that was caused in part by a subconsultant who is unwilling to contribute to the fix, but is nonetheless someone for whom you are contractually responsible. These situations often cannot wait for other parties and their carriers to come to the table and negotiate a settlement when there is a concern that even a modest delay will impact the critical path and delay project completion resulting in massive delay damages.

If there are waivers of subrogation clauses in the contracts, your insurance carrier will not be able to recoup its losses. This poses a potential problem for you for two reasons: First, your firm will have to pay a deductible. In addition, your insurance carrier's payment will appear on the firm's loss history—all because the damage caused by the contractor cannot be recouped by your insurance company.

Not all insurance carriers are alike

Design professionals are often called on to sign contracts with waivers of subrogation; refusing to do so could result in significant loss of business opportunities. Before you agree, however, carefully review your professional liability policy and speak with your insurance broker to make sure that you have the authority to waive subrogation on behalf of your insurance company.

XL Catlin supports its insureds' business by including a waiver of subrogation provision that is standard in the policy. As a result, XL Catlin agrees to waive its rights of subrogation against the clients of the insured firm for claims arising out of professional services under the client's contract requiring a waiver of subrogation, subject to the terms of the contract. In other words, if you successfully negotiate a waiver of subrogation in your contract with a client, XL Catlin will support your decision and waive its right of subrogation against your client.

If your insurer does not provide a waiver of subrogation, you should consider the consequences of not having this important policy enhancement by consulting with your insurance professional or your attorney.



Tips for negotiating a waiver of subrogation

If you are negotiating a waiver of subrogation in your contract, negotiate the broadest waiver possible, and be mindful of the following:

1. All parties must have the same waiver.

The contractors need to have the same waiver of subrogation in their contracts as well. Make sure you confirm that everyone involved in the design and construction of the project has the same waiver of subrogation.

2. The waiver should apply to all types of insurance.

Seek a waiver of subrogation that applies to all types of damages and not just property damage. This will help safeguard you from subrogation claims brought by workers' compensation carriers seeking to recover payments made to workers who were injured due to the fault of others.⁵

3. The waiver should extend beyond final payment.

Avoid a waiver of subrogation that ends with your final payment, and instead seek to extend it beyond construction. By doing so you can help avoid subrogation lawsuits by a property insurer who pays to fix a building after it is completed when the catastrophic event leading to the loss is due in part to a negligent design.⁶

4. Don't forget the basics.

Even after you negotiate a waiver of subrogation, you can still open yourself up to a subrogation claim if you do not follow disciplined contracting.

- Make sure your professional services do not extend beyond those services set forth in your original contract's scope of services provision, otherwise you might lose the benefit of a waiver of subrogation.
- If you need to take on additional responsibilities, it is always a good idea to amend your contract such that the waiver of subrogation and other key contract terms apply to the additional scope of work items. If unamended, additional professional services outside your originally contracted scope may leave you as the sole target defendant in a subrogation action.

If you find yourself facing decisions about waivers of subrogation, XL Catlin and your insurance professional are here to help. Should a dispute arise, our experienced claims staff is familiar with waivers of subrogation, and can assist in resolving the matter in the most effective manner. As with any contract terms, we strongly recommend that you also consult with competent legal counsel prior to drafting, negotiating or signing any contracts. The information in this paper is intended to address risk management and insurability concerns, and does not constitute legal advice.

⁵ Not all states allow waivers of subrogation for workers' compensation losses; consult with your insurance broker and your attorney to find out what the law is in your state or province.

⁶ For example, assume that high winds damaged a building's roof, and the property insurer paid to repair the damage. If the roof failed in part due to negligent design, then the property carrier could subrogate the claim and file a lawsuit against the design professional.