Waiving a Liability Insurers Right to Subrogation Is it Appropriate?

The Legal Intelligencer

December 6, 2024

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When it comes to negotiating the insurance and risk-shifting terms of any garden variety business contract, the oft-used but rarely understoodor vaguely understood waiver of subrogation arguably takes the lead for provisions that unnecessarily slow things down and engender confusion. An increasingly common source of delay and confusion seems to be whether a contracting party will, or even can, waive its liability insurers subrogation rights against the other party, especially when the latter is required to be listed as an additional insured on the first partys liability insurance policy. At best, confusion in this area can gum up the works during negotiations and slow things down. At worst, it can lead to very unpleasant surprises down the road.

Lawyers are already famous in the eyes of their business counterparts for slowing down the contracting process by either haggling over unimportant issues or being too afraid of unavoidable or minor business risks. Shedding light on issues attendant to waiving a liability insurers subrogation rights may give lawyers some of the tools needed to avoid contractual pitfalls and improve efficiency.

Before shedding that light, it may be helpful to examine what exactly a waiver of subrogation is. To subrogate means to put in the place of another to substitute (something or someone, such as a second creditor) for another with regard to a legal right or claim. (Subrogate, Merriam-Webster Online Dictionary.) Put another way, it is the right of one party (the subrogor) to assert the legal rights of another party (the subrogee). The subrogor steps into the shoes of the subrogee and can assert the subrogees legal claims.

Virtually all insurance policies grant the insurer the right to subrogate to the insureds claims against a third party when the insurer pays for a loss that was caused by that third partys fault. The relevant policy provision is typically named Transfer of Rights of Recovery Against Others to Us.

Consider the following illustrative example. A property management company manages a building owners apartment building. The management companys employee negligently causes a fire that damages the building. The building owner has two basic options. It can investigate, hopefully identify the responsible party, and sue that party, all while shouldering the expense of repairs, or it can file an insurance claim with its property insurer. Not surprisingly, our building owner seeks payment from its property insurer so it can more quickly repair its damaged property and get back to business. When the insurer pays the loss, it may then exercise its right to subrogate to its insureds claim against the negligent management company responsible for the loss. That is, the insurer can sue the company to recover its loss payment.

The above is a straightforward and typical example of subrogation in the insurance context. A waiver of subrogation in a commercial contract quite simply waives one partys insurers right to subrogate against the other contractual party. Because an insured cannot unilaterally waive its insurers subrogation rights granted in an insurance policy, an insured must ask its insurer to agree to the waiver. In the commercial property policy context, insurers will often agree by endorsing the policy by a way of a blanket endorsement waiving all subrogation rights where required in a commercial contract to which the insured is a party.

Continuing our example, assume the property management company was able to negotiate a waiver of subrogation in its favor in the contract with the building owner. Also assume the building owner secured a blanket endorsement to its property policy waiving subrogation when required by contract. In that instance, the building owners property insurer could not subrogate to the building owners claim against the management company and is stuck with paying the loss.

Pretty straightforward, really. So why do waivers of subrogation seem to cause so much confusion? One reason is that parties automatically include them in contracts without fully understanding their purpose and tailoring them in a way that makes sense in the relevant context. Sometimes parties confuse, or confusingly combine, a waiver of subrogation with a release, indemnification, and/or additional insured requirements. A waiver of subrogation is none of these, although it should work together with a release and indemnity to accomplish the contracting parties risk-shifting objectives. Another reason is that parties will automatically demand a waiver of subrogation in circumstances that make no sense or are not appropriate.

Case in point, it seems as if contracting parties are increasingly demanding that their counterparts waive their liability insurers subrogation rights in addition to their property insurers subrogation rights. There are few situations in which such a waiver can have any practical relevance, though there may be better ways to address those situations than a subrogation waiver. Accordingly, demanding that a party waive its liability insurers subrogation rights without a real, practical reason for doing so can unnecessarily protract the negotiation process.

Whether a liability insurance subrogation waiver is appropriate depends on the industry and the typical liabilities it faces. Blindly demanding a waiver because it is in a form contract can lead to unnecessarily protracted contract negotiations. Likewise, blindly agreeing to one without understanding its potential effect can lead to unintended consequences.

Another example illustrates the point. Returning to the above example, assume the building owners and property managers contract requires the latter to maintain liability insurance. It also requires the management company to list the building owner as an additional insured on its liability policy. It also requires that the management company defend and indemnify the owner against third party claims for bodily injury or property damage involving the building. All these provisions are common and appropriately shift the risk of third-party liability to the party operating the building. Now assume the building owner takes it a step further and demands a waiver of subrogation in its favor respecting the management companys liability insurance.

In that situation, the management companyand perhaps its liability insurermay balk. It may not be able to secure the waiver from its insurer, or the waiver may materially increase its premiums or negatively impact its loss history. It may fairly ask why the building owner would even need such a waiver and, in many instances, the waiver may have little practical benefit.

For example, if someone gets hurt and sues the management company and the building owner, the building owner will, all else being equal, be covered as an additional insured under the management companys policy. A liability insurer cannot subrogate against its own insured, including additional insureds, for a covered payment it makes on their behalf. That would be antithetical to the entire purpose of liability insurance.

In addition, even if for whatever reason the building owner were not covered as an additional insured for a given claim, and thus the management companys insurer could theoretically subrogate against it, the management company itself would still have to step in and protect the building owner pursuant to its contractual indemnification. Finally, the building owner would still have its own liability insurance. Thus, the building owner would have three layers of protection in the event of a third-party claim. Arguably it does not need a waiver of subrogation and perhaps should not hold up a contract by insisting upon one.

In fact, there seem to be very few situations where a waiver of subrogation in the liability insurance context makes sense. For example, a waiver of a workers comp insurers subrogation rights may be appropriate to ensure occupational hazards are shifted to workers comp insurance, if permitted by state law.

Another example is if the liability insurance limits required by a commercial contract are lower than the actual policy limits maintained by the party required to purchase the liability insurance. In many modern commercial general liability policies, the coverage offered to an additional insured may be subject to the limits required in a contract between the insured and the additional insured. In that situation, the insurer could pay a claim that exceeds the limits required to be maintained in the commercial contract and subrogate against the additional insured for the difference. Of course, instead of demanding a waiver, a party may simply require higher limits in the contract.

In conclusion, waivers of subrogation are a specific risk-shifting provision and should be used appropriately. In the liability insurance context, unlike the property insurance context, their utility may be of questionable value to the beneficiary and may be overly burdensome to the party required to give one. Therefore, it is important for contractual parties to understand what a waiver of a liability insurers subrogation rights would achieve in a given context before insisting upon receiving one or giving one.

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ATTORNEYS MENTIONED

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