

# Understanding Waivers Of Subrogation

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Waivers of Subrogation are a necessary evil of underwriting, but their application and effect on subrogation are rarely understood. One of the ways to avoid subrogation is through the implementation and enforcement of waivers of subrogation. Just as the insurer has a legal right to pursue subrogation, so too does a party to a commercial transaction have a right to structure the transaction so that the party's legal rights of recovery against another party are abrogated or somewhat limited. Such clauses, known as exculpatory clauses, have as their intent and effect, to limit a party or that party's insurer from subrogating against another party to a transaction.

## WAIVERS OF SUBROGATION GENERALLY

Technically, exculpatory clauses are not themselves waivers of subrogation. Rather, one or both parties to the contract waive their right to sue for and recover from the other any damages which arise out of the contract or a transaction. Since one party's right to recover from another party has been waived, the first party's insurer's right to subrogate against that other party may also be waived, even where the insurer pays the loss. This is because the insurer "steps into the shoes" of the first party. Below is typical insurance contract language which makes it clear that such an exculpatory clause may be in violation of the terms of the policy.

## ISO COMMERCIAL PROPERTY CONDITIONS SUBROGATION CLAUSE

### I. Transfer of Rights of Recovery Against Others To Us

If any person or organization to or from whom we make payment under this Coverage Part has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing after loss to impair them. But you may waive your rights against another party in writing:

1. Prior to a loss to your covered Property or covered income.
2. After a loss to your covered property or covered income only if, at the time of loss, that party is one of the following:
  - a. Someone insured by this insurance;
  - b. A business firm:
    - (1) Owned and controlled by you; or
    - (2) That owns or controls you; or
  - c. Your tenant.

This will not restrict your insurance.

SOURCE: ISO COMMERCIAL RISK SERVICES, INC., 1983, 1987.

As you can see, such an exculpatory clause under these terms is allowed if entered into *before* the loss, unless the party you are exculpating or releasing is someone insured by the same policy, a business firm owned or controlled by you or your tenant. In that case, the policy terms allow the exculpatory clause to be entered into after the loss.

Entering into an exculpatory clause after a loss in violation of policy terms will not affect the viability or effectiveness of the release itself, but may jeopardize insurance coverage or provide a carrier with a cause of action against its own insured for breach of contract.

The actual "waiver of subrogation" in many instances, is actually found in a contract, such as a construction contract or lease, in connection with which the waiver is sought.

## EXAMPLE OF WAIVER OF SUBROGATION

**Gencon**, as general contractor, enters into a contract with **Owncorp** to construct a retail shopping center. The contract requires **Owncorp** to provide builder's risk insurance on the project and includes a provision whereby **Owncorp** and **Gencon** waive all rights against each other for damages caused by fire or other perils to the extent covered under the builder's risk policy. The builder's risk policy is issued by **P&L Insurance Company** and contains a provision granting permission to the insured to waive in writing recovery rights against the others prior to a loss.

According to normal procedure, both **Owncorp** and **Gencon** are named as insureds on the policy. When the project is half completed, a fire caused by one of **Gencon's** employees destroys the building. **P&L** pays the loss and looks for a way to recover its loss. Since **Owncorp** and **Gencon** have waived the rights of recovery against each other, **P&L**, which must step into the shoes of **Owncorp**, is prevented from subrogating against **Gencon**, even though the negligence of **Gencon's** employee caused the loss. This occurs because **Owncorp** has in essence already released **Gencon**, and there can be no right of subrogation where the subrogator has no cause of action against the third party. In addition, **Gencon's** status as an insured on the **P&L** policy should also bar recovery by **P&L** against **Gencon**.

Thus it can be seen that a "waiver of subrogation" actually involves two separate provisions.

1. A waiver of subrogation clause contained in the contract between the parties; and
2. A provision in the insurance policy, or an endorsement to that policy, granting permission to the insured to waive in writing, recovery rights against the others **prior to loss**.

**SUBROGATION WAIVERS AND STANDARD LINES OF INSURANCE**

Waiver of subrogation provisions take various forms in commercial lines property and casualty insurance policies, as well as in workers' compensation policies.

*Commercial General Liability.* Most insurers write general liability insurance on the ISO Commercial General Liability (CGL) Form CG 00 01. Condition 8 of the CGL policy affirms the carrier's legal right to subrogation and requires the insured to cooperate with the insurer in its efforts to subrogate. Condition 8 of CGL policy impliedly (though not expressly) allows an insured to waive recovery against a third party prior to loss. The ISO has nonetheless promul-

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gated a standard waiver of subrogation endorsement entitled the Waiver of Transfer of Rights of Recovery Against Others to Us (GC 24 04).

Closely related to Endorsement CG 24 04 is the Waiver of Transfer of Rights of Recovery Against Others to Us (CG 29 88) Endorsement, which is attached to an Owners and Contractors Protective (OCP) Liability Policy in order to waive subrogation.

*Commercial Automobile Insurance.* There is no endorsement in the ISO forms portfolio to effect a waiver by endorsing the business auto policy as there is within the CLG forms portfolio.

*Commercial Property and Inland Marine.* Commercial property and inland marine carriers give their insureds a right to waive their rights of recovery against third parties prior to a loss. Many commercial property and inland marine (e.g., builder's risk and contractors equipment insurance) policy forms include subrogation clauses that imply permission to grant pre-loss waivers in a manner similar to the approach of workers' compensation, business auto, and CGL policies. Some forms, particularly inland marine forms, however, may specifically deny the insured the right to waive subrogation. Still other forms, such as the standard commercial property forms developed by Insurance Services Office, Inc. (ISO), grant even broader rights to the named insured. ISO Commercial Property Conditions Form CP 00 90 is one of the forms used to effect this waiver.

Rather than granting the right to waive subrogation by implication, the ISO commercial property insurance policy clause specifically states that as long as it is in writing, the named insured may execute a pre-loss waiver of subrogation. Therefore, there is clearly no need to attach an endorsement waiving subrogating rights to this ISO policy. Post lost waiver exceptions are given under the same terms as in a CGL policy. The provision permitting waiver of subrogation subsequent to a loss against the tenant is of some significance. It could come into play in a situation where the lease agreement executed prior to the loss does not include a waiver of subrogation, but the landlord desires to waive rights to maintain the business relationship with its tenant.

Since builder's risk policies are written on a great variety of forms, it is especially critical for an insured to determine whether the policy prohibits the insured from waiving recovery rights against another. If the policy does prohibit such waivers, and the contractor enters into a typical construction contract containing the mutual waiver subrogation provision, the contractor may have violated policy conditions and voided the coverage. On the other hand, it might also be the case that the contractor does not have an effective waiver of

subrogation, because the insurer has not given its permission for such a waiver. In that case, the insured would have breached its construction contract and may be liable to the other party to the construction contract. Builder's risk insurers are hesitant to allow waivers of recovery against design professionals since design errors frequently cause covered losses.

**WORKERS' COMPENSATION INSURANCE**

There isn't another area in which subrogation and waivers of subrogation play a more important role than in workers' compensation insurance. Since workers' compensation coverage is mandatory in most states, the opportunities for subrogation in connection with a huge number of claims exist. Moreover, because employers and their workers' compensation carriers are strictly liable for statutory benefits to their employees, benefits are paid in connection with every bonafide occupational injury. Where the injury is of a large enough magnitude, the level of benefits increases and, under all states' laws, a carrier which has paid out statutory benefits is subrogated to the rights of the employee against a third party which may have caused or contributed to the injury.

Where the employee is allowed to pursue a recovery from a third party, the right of the workers' compensation insurer to subrogate is based on one or more of the following equi-

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table principles:

1. To prevent double recovery;
2. To protect the employer from common law negligence suits by employees;
3. To prevent the third-party tortfeasor from escaping liability for negligence; or
4. To reduce the premiums paid by the employer through subrogation remedies from third-party tortfeasors (placing the burden of the loss on the one who caused the loss).

Some of these foundations for subrogation are seriously compromised or tested where there is a contractual relationship between the employer and the third party against whom the employee is seeking additional recovery. In many cases, that employer is also contractually obligated to indemnify and hold harmless the third party or the third party is named as an additional insured on the employer's commercial general liability policy. Thus, despite the theory of workers' compensation that an employer's liability to its employee be capped at the statutory amount of benefits (i.e., the "exclusive remedy"), due to these contractual risk transfer mechanisms between the third party and the employer, the employer's liability can far exceed its statutory liability under workers' compensation.

This problem is compounded where the employer has given the third party a waiver of subrogation. Such a waiver can require the employer to pay twice for an employee's injury, once through workers' compensation benefits and then also by paying the damages attributable to the negligence of the third party which it has agreed to indemnify or name as an additional insured on its CGL policy. Such a *double recovery* is made possible by the waiver of subrogation, which prevents the employer's workers' compensation carrier from subrogating against the third-party recovery and allowing the employee to recover twice for his damages, once from the workers' compensation benefits and once from the third-party recovery. Together, the waiver of subrogation and the indemnity agreement emasculate the sole remedy rule in workers' compensation.

Historically, the use of waivers of subrogation arose due to the provisions in many workers' compensation laws which required the employee to make a statutory election to recover workers' compensation benefits under the particular state law, or to pursue a third-party action against the third-party tortfeasor, but not both. Theoretically, the employee would choose the medical and indemnity benefits available under the workers' compensation statute and return to work, foregoing the uncertainty of a third-party action against the tortfeasor. After paying benefits, a worker's compensation carrier had a right to file its own subrogation lawsuit against the tortfeasor. This resulted in many

entities inserting waivers of subrogation into their contracts with service providers, such as construction or maintenance contractors, automatically, in order to block the workers' compensation carrier from subrogating. It should be remembered that such a waiver of subrogation will never prevent the employee himself from suing. The employers which contracted with these larger entities usually had little or no choice but to comply with requirements primarily due to the disparity in bargaining power. Presently, most modern workers' compensation laws no longer require such an election and an employee can pursue both workers' compensation benefits and a third-party lawsuit at the same time. This means that although much of the early rationale for waivers is now gone, they continue to appear as a contractual requirement in many settings.

### WAIVERS OF SUBROGATION UNDER STATE LAW

Most state workers' compensation laws, or case law construing them, allow the employer and its carrier to waive its right to subrogate against a third party which may have caused or contributed to an employee injury. For example, the State of Indiana provides for waivers of subrogation, thereby relieving the carrier of its obligation to pay the pro-rata share of costs and expenses, including attorneys' fees, incurred in pursuing a third-party recovery.

Other states have reached the same result through judicial construction of their workers' compensation acts. For example, in *National Union Fire Insurance Company of Pittsburgh, PA. v Pennzoil Company*, 866 S.W.2d 248 (Tex. App. - Corpus Christi, 1993, no writ), the court enforced a waiver of subrogation clause in a Certificate of Insurance executed by a worker's compensation carrier in favor of the oil company which had hired the insured contractor to drill a well for it. The waiver prevented the carrier from intervening in a third-party action brought by the contractor's injured employee against the oil company.

States which recognize the enforceability of waivers of subrogation include Florida, Georgia, Illinois, Maryland, Michigan, New York, North Carolina, Ohio, Tennessee, Virginia, and Washington. At the same time, states such as Kentucky and Missouri do not allow waivers of subrogation in the workers' compensation setting, and declares them contrary to public policy and void. These prohibitions against waivers of subrogation are the exception, rather than the rule. Many states, including Texas, however, require that an insurer actually *consent* to a waiver of its subrogation rights. This consent is usually exhibited by amending the workers' compensation policy with a waiver of subrogation endorsement.

Most of the litigation underpinning waivers of subrogation deals with the interpretation of the contract in which a waiver of subrogation requirement appears, or the endorsement itself, which provides the language by which the

insurance carrier consents to the waiver of subrogation. The above Texas Waiver of Subrogation Endorsement has been the subject of much litigation. In one Texas case, Gary L. Wickert represented the interest's of Hartford Accident and Indemnity Company, attempting to subrogate in a catastrophic injury case in which it had paid nearly \$1.5 million.

In *Hartford Accident & Indemnity Co. v. Buckland*, 882 S.W.2d 440 (Tex. App. - Dallas 1994, writ denied), Hartford issued the above waiver endorsement to Phillips Petroleum and later paid out \$1.5 million in benefits to Theodore Buckland for an injury allegedly resulting from the actions of Phillips Petroleum and Phillips 66. The

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issue was whether or not the subrogation endorsement extended to Phillips 66, as well as Phillips Petroleum, and whether or not Hartford would be entitled to take its "statutory credit" for the \$3.2 million judgment Buckland received. Focusing on the language which in the endorsement which reads:

*"We have the right to recover our payments from anyone liable for an injury covered by this policy. We will not enforce our right against a person or organization named in the Schedule, but this waiver applies only with respect to bodily injury arising out of the operations described in the Schedule where you are required by a written contract to obtain this waiver from us."*

The court determined that the waiver of subrogation included the waiver of the right to a credit, not withstanding the millions of dollars recovered by the plaintiff. The court also held that the endorsement extended to Phillips 66 because the endorsement mentioned the waiver being applicable to "Phillips Petroleum, its subsidiaries, and related entities." For a \$130.00 premium, Hartford lost millions in subrogation rights and had to continue paying medical and indemnity benefits to a catastrophically injured worker. Underwriters should be reminded that waivers of subrogation should not be taken lightly, and should cost more in states like Texas, where large reserve take-downs hang in the balance, than in Georgia, where a "credit" is not taken, regardless of how much the injured worker recovers in his third party action.

**LITIGATION INVOLVING WAIVERS OF SUBROGATION**

There is some divergence in state law with regard to whether a waiver of subrogation merely prevents a carrier from filing a subrogation lawsuit against a third party or whether it also prevents a carrier from recovering its statutory right to reimbursement from an injured third party recovery. In states such as Texas, they are construed to prevent both. Other states, such as Alaska, Maine, and Wisconsin, recognize the importance of workers' compensation subrogation and allow recovery of the lien notwithstanding the existence of a waiver of subrogation endorsement.

In most states, the elements of an effective waiver of subrogation are:

1. A contract in writing between the insured and the third-party tortfeasor, wherein the insured agrees to obtain a waiver of subrogation in its insurance policy;
2. The insurance policy by its terms or by an endorsement to the policy must expressly provide that the insurance company has approved, consented, or is aware of the waiver of subrogation; and
3. Any such waiver of subrogation endorsement and its attendant premium must be paid for by the insured (consideration).

When wearing your subrogation hats, insurance professionals should take time to examine policy terms and endorsements to determine the exact extent of an insured's subrogation rights or their waiver of those rights. In the example of the typical Texas waiver endorsement, it is clear that in order for the waiver to be effective, the injury has to be incurred in connection with the operations described in the Schedule on the endorsement. The waiver applies only to the specific person named in the endorsement (unless it is a blanket waiver, in which case the waiver is applicable only against a party with whom the insured has agreed by written contract prior to the loss to furnish the waiver endorsement), and the endorsement premium must be paid or there is no consideration for the endorsement to the contract.

Waivers of subrogation are a necessary evil in the complex world of commerce and contracts. However, underwriters should be stingy in granting them and subrogation personnel should carefully examine all contracts and waiver endorsements in an effort to exhaust every possible of recovery source. Depending on the state in which the claim is being paid, millions of dollars may hang in the balance. 🦋