



The Risk of Waiving

Understanding the Impact of Subrogation
Waivers on Workers' Compensation Policies

By Gary L. Wickert

At the end of Mark Twain's *The Adventures of Tom Sawyer*, Tom and Huckleberry Finn are heroes, but Huck still doesn't like wearing normal clothes, going to church, or conforming to society. When Huck asks why he has to do these things, Tom says, "Well, everybody does it that way, Huck." A similar reason is given when companies ask why they must include a waiver of subrogation endorsement in a workers' compensation policy. The answer is rarely satisfying, but the contract is signed anyway. In the end, waivers of subrogation and their role in the economics of business and insurance remain one of life's more costly imponderables.

Waivers of subrogation are a necessary evil of underwriting, but its application and effect on subrogation and the best interests of the insured are rarely understood or appreciated. A party to a commercial transaction has a right to structure a contractual deal in order to limit legal rights of recovery against it to the extent allowed by law. Such clauses, known as exculpatory clauses, have as their intent and effect to limit a party or a party's insurer from subrogating against another party to a transaction.

Waivers of Subrogation Generally Speaking

A waiver of subrogation is a three-way agreement between an employer, the employer's workers' compensation carrier, and a third party with whom the employer contracts and who insists on a



waiver of subrogation as a condition of doing business. (Ask why and you'll get the Tom Sawyer-like answer.) To properly implement an effective waiver of subrogation involves two separate steps and provisions.

- ❶ A waiver of subrogation clause contained in the contract between an employer and a third party (frequently an owner or general contractor).
- ❷ 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 a loss.

Waivers of subrogation take various forms in construction settings. A non-workers' compensation carrier subrogated to the rights of its insured/project owner against a negligent subcontractor has the rights that the owner has against the subcontractor only. If the owner has contractually indemnified and held harmless or otherwise exculpated the contractor, the owner's insurer generally cannot subrogate to recover its loss from the contractor. In these circumstances, the waiver actually serves its purpose: The owner's insurer cannot file a subrogation suit against the contractor to recover damages. Rarely does the insurer recover enough in additional premiums to offset the recovery of potentially millions of dollars in a single claim.

The situation is quite different when a construction contract requires a contractor to provide a workers' compensation policy that contains a waiver of subrogation endorsement. With workers' compensation, the carrier is normally subrogated by statute to the rights of the injured employee, not the insured/employer. In the workers' compensation context, if a contractor's employee is injured due to the owner's negligence, the owner's injured employee will be able to file suit against the owner or subcontractor regardless of

any waiver of subrogation contained in the contract or any waiver endorsement in the workers' compensation policy.

Although it varies from state to state, the employer or its workers' compensation carrier is then subrogated to the rights of the employee against any third-party tortfeasor, including the owner, and is given a right of reimbursement should the employee make a tort recovery from that tortfeasor. The owner still must face a lawsuit from the injured employee, notwithstanding the waiver. The only thing that has changed is that, instead of some of the settlement from the lawsuit going to the subro-

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gated workers' compensation carrier, it all goes to the employee. Good for the employee; bad for the employer. The contractor's experience modifier goes up, and so does its premiums. The only winners are the employee and the employee's lawyer.

Waivers of subrogation play a key role in workers' compensation insurance. Since workers' compensation coverage is mandatory in most states, there are lots of opportunities for subrogation. Moreover, because employers and their workers' compensation carriers are liable by statute strictly for paying unlimited medical expenses and other benefits to their employees, benefits are paid in connection with every bona fide occupational injury. The costly

phenomenon of ubiquitous waivers of subrogation in such scenarios is beyond explanation. Having handled thousands of such claims, I can tell you that the employer—which is usually most interested in making sure that its risk modifier and future premiums stay low—can explain the waiver only by saying that the owner or general contractor required it. When the owner or general contractor is quizzed about the need for the waiver, they can explain it only by saying it was in the form they were told to use. Even lawyers who suggest the addition of waivers into contractual agreements often do so without understanding the full ramifications or being able to explain why.

In workers' compensation settings, the existence of a waiver of subrogation endorsement can require the employer to pay twice for an employee's injury. How? Once through workers' compensation benefits and again by paying the damages attributable to the third party's negligence, which it has agreed to indemnify or name as an additional insured on its commercial general liability policy. The waiver prevents the employer's workers' compensation carrier from subrogating against, receiving reimbursement from, or obtaining a future credit out of the third-party recovery and simultaneously allows the employee to recover twice for damages. When employed in combination, the waiver of subrogation and the indemnity agreement can eviscerate the sole remedy rule in workers' compensation.

Historically, the original use of waivers of subrogation arose due to the provisions in many workers' compensation laws that 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 dependable medical and indemnity benefits available and return to work, foregoing the uncertainty of a



third-party action against the tortfeasor.

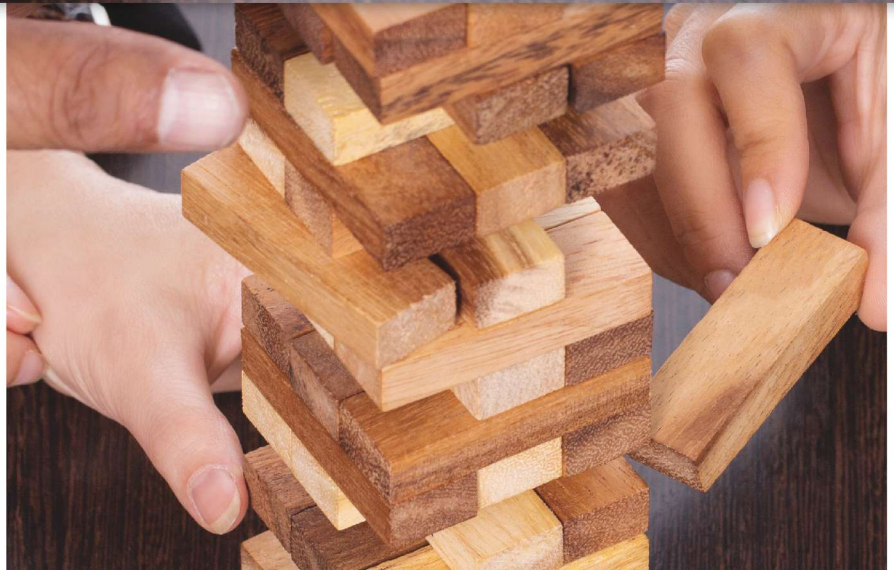
After paying benefits, a workers' compensation carrier had a right to file its own subrogation lawsuit against the tortfeasor. In order to avoid a pesky subrogation suit, many entities inserted waivers of subrogation into their contracts. The employers that contracted with these larger entities usually had little or no choice but to comply with requirements primarily due to the disparity in bargaining power.

As workers' compensation law in America evolved, every state's workers' compensation laws eventually eliminated this election. Today, an employee can pursue both workers' compensation benefits and a third-party lawsuit simultaneously. Unfortunately, even though the original rationale for waivers is now gone, waivers continue to appear as a contractual requirement in many settings. Why? "Well, everybody does it that way, Huck." An entity protected by a workers' compensation waiver of subrogation will owe no more and no less than if the waiver didn't exist. The only difference is that the employee and his attorney will receive a bigger check, while the innocent employer will receive an increased risk modifier and increased insurance premiums. It couldn't be more backward.

Waivers of Subrogation Under State Law

Significant dollars are lost with the stroke of a pen. As a result, many states have begun to legislate when and under what circumstances a waiver of subrogation can be required. Some states allow the employer and its carrier to waive the right to subrogate against a third party that may have caused or contributed to an employee injury. For example, Iowa law is silent on the subject, which allows parties to freely contract as they wish. Other states have reached the same result through judicial construction of their workers' compensation acts.

In *National Union Fire Ins. Co. of Pittsburgh, Pa., v. Pennzoil Co.*, a Texas



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court enforced a waiver of subrogation clause in a certificate of insurance executed by a workers' compensation carrier in favor of the oil company that hired the insured contractor. The waiver prevented the carrier from intervening in a third-party action brought by the contractor's injured employee against the oil company.

States that recognize the blanket enforceability of waivers of subrogation include Florida, Georgia, Illinois, Maryland, Michigan, New York, North Carolina, Ohio, Tennessee, Virginia, and Washington. Some states, such as Kentucky and Missouri, do not allow waivers of subrogation in the workers' compensation setting and declare them contrary to public policy and void. These prohibitions against waivers of subrogation are the exception rather than the rule.

Many states, including Texas, require that an insurer actually consent to a waiver of its subrogation rights,

which is usually exhibited by amending the workers' compensation policy with a waiver of subrogation endorsement. This means that if the employer contracts to provide a waiver of subrogation against the owner and its injured employee sues the owner, the workers' compensation carrier still is able to subrogate or seek reimbursement notwithstanding the waiver unless the carrier has consented to the waiver. This consent normally is expressed when the carrier charges the insured and is paid an additional premium for 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 in the endorsement itself, which provides the language by which the insurance carrier consents to the waiver of subrogation. Just because there is a contract requiring a waiver and a waiver of subrogation endorse-



ment in the policy doesn't mean there is a waiver. The waiver endorsement has very specific language, which can limit the applicability of the waiver to a single entity or to any entity with whom the employer is contractually required to provide the waiver. You then have to look at the contract itself to see if the waiver is valid.

The full effect of a valid waiver of subrogation also is a matter that is frequently litigated. Does the waiver prohibit the carrier only from filing a third-party subrogation suit against the party it benefits? Or does it also prohibit the carrier from receiving reimbursement from that party, an entirely separate right under the law of 49 states? And even if it prohibits the direct filing of a third-party suit and the right to reimbursement, does it also prohibit something often more important than recovering the workers' compensation lien—the right to a credit toward future benefits for the recovery made by the injured employee? These are huge questions involving potentially millions of dollars that are often overlooked and underemphasized.

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:

- ❶ A contract in writing between the insured and third-party tortfeasor, wherein the insured agrees to obtain a waiver of subrogation in its insurance policy.
- ❷ The insurance policy by its terms or by an endorsement to the policy must provide expressly that the insurance company has approved, consented, or is aware of the waiver of subrogation.
- ❸ Any such waiver of subrogation

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endorsement and its attendant premium must be paid for by the insured (consideration).

Insurance underwriters—those involved in the mysterious process of evaluating the risks involved and charging a reasonable premium based on that risk—should be reminded strongly that waivers of subrogation should not be taken lightly, should be included in a policy only as a last resort, and should cost more in subrogation-friendly states like Texas, where large reserve takedowns 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. Underwriters and insurance agents should make sure that their clients fully understand the ramifications of requesting a waiver of subrogation. All but a few, namely the largest companies having dedicated risk managers and loss prevention departments, understand the full cost of what they are doing.

When looking for subrogation, insurance professionals should examine policy terms and endorsements to determine the exact extent of an insured's subrogation rights or their waiver of those rights. If significant liens or reserves potentially are involved, subrogation counsel always should be consulted. Do not walk out on subrogation simply because a contract requires your insured employer to obtain a waiver, and do not abandon subrogation efforts simply because there is a waiver endorsement in the policy.

Many preconditions must be in place for such a waiver to take effect. 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 else there is no consideration for the endorsement to the contract.

In the final analysis, companies and contractors demand waivers of subrogation because others demand waivers of them. It is something far short of a sound financial strategy, yet it prevails even in today's “sophisticated” business climate. Underwriters and insurance agents should be stingy in granting them and should receive fair compensation when doing so. The vicious cycle starts with them. Subrogation personnel should carefully examine all contracts and the specific scope and limitations of such waiver endorsements in an effort to exhaust every possibility for subrogation recovery, and they should consult with subrogation counsel before tossing any claim into the subrogation dumpster. ■

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