Subrogation. It is a phrase appearing in virtually every insurance contract, but rarely understood except by insurers and attorneys. It is a term frequently glazed over by insureds as they are daunted by a veritable mountain of insurance documents on their desk, often over an inch thick. But what does it mean? And what if, in a contractual setting, you are asked to waive subrogation? Waiver of subrogation is not something that should be agreed to lightly, because a misstep without fully understanding the ramifications could very well lead to a denial of coverage.

First things, first. What is subrogation? In the insurance context, subrogation is defined as “... [t]he principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy” Lee R. Rugg, Couch On Insurance § 222.2, at 222-14 (3d ed.2000). In layman’s terms, subrogation occurs when an insurer pays an insured for a loss caused by a third party. The insurance company is then “subrogated” – or steps into the shoes of the insured – to sue that third party for the loss suffered by the insured. In short, the insurance company pays its insured to make the insured whole. The insurer, to make itself whole, then has the right to sue the third-party that caused the damage.

Because an insurer pays on its policy for losses suffered by the insured to make that policy holder whole, the insurer is out significant amounts of money. The only way for it to recoup that money is to sue the party responsible for the loss. Therefore, insurance policies include terms that require its insured not take any actions which would compromise the insurer’s right to subrogation. The general policy language usually states “Insured will not act in any way that would limit or otherwise diminish the insurer’s right of subrogation.”

Despite this generally universal insurance policy term, often times commercial contracts between parties (not the insurer) will include “waiver of subrogation” provisions. These are most often found in construction and lease contracts. A waiver of subrogation provision prevents the insurance company (who steps into the shoes of the insured after it pays a loss) from suing the other party to the contract – which likely caused the loss. Moreover, waiver of subrogation provisions found in contracts are generally upheld by Courts.
Because insurance policies almost always include terms which prevent the insured from taking any actions which would limit or diminish the insurer’s right of subrogation, what happens if you sign a contract that includes a waiver of subrogation? The simple answer is: you, the insured, have breached the insurance contract. Simply stated: the insurance company will deny you coverage and will not cover you for the loss incurred under the insurance policy.

What if, however, you entered into a contract with a party who then sub-contracts a portion of the work, and the sub-contract contains a waiver of subrogation? Such issue occurs more often than one might expect and was an issue that was raised in Travelers Indem. Co. v. Crown Corr., Inc., 2011 WL 6780885 (D.Ariz. 2011). In that case, Tourism and Sports Authority, the owner of the University of Phoenix Stadium, entered into a contract with the Arizona Cardinals and Hunt Construction for the design and construction of the Arizona Cardinal’s stadium. To complete the stadium, Hunt entered into a sub-contract with Crown Corr, Inc. to design the exterior enclosure system for the stadium. Unbeknownst to Tourism and Sports Authority, the Hunt-Crown sub-contract contained a waiver of subrogation provision.

After the stadium opened, during a wind and rain storm, certain panels installed by Crown Corr fell off the exterior of the stadium, causing roughly $1.5 million in damage. Tourism and Sports Authority, owner of the stadium submitted its claim to Travelers, who paid the claim – and then filed suit against Crown Corr (as subrogee of the stadium owner) to recover the $1.5 Million claiming negligent construction. Crown Corr responded by filing a motion to dismiss, asserting that the contract it entered into as a subcontractor contained a waiver of subrogation clause.

The Court held that although the owner of the stadium did not enter into the subcontractor agreement with Crown Corr, Inc., it had the right to review the contract which contained the waiver of subrogation clause. Travelers, as subrogee, stands in the shoes of its insured and is bound by these agreements. The Court went on to say: “insurers are in the best position to protect themselves against waivers of subrogation entered into by their insured before the acquisition of the insurance policy by (1) inserting an exclusion into their policies that permits the insurers to deny coverage if any insured waive[d] the insurer's subrogation rights, (2) raising premiums to offset outlays incurred from the loss of their subrogation rights, (3) investigating whether a potential insured has already waived any subrogation rights, (4) requiring insureds to warrant at the time a policy is issued that their insureds have not, and will not, waive the insurers' subrogation rights, and (5) obtaining reinsurance to cover any waiver of subrogation rights.” Based on this, the Court held that Travelers was bound by the waiver of subrogation rights and was barred from asserting claims against Crown Corr.

While Crown Corr narrowly escaped liability based on the Court’s ruling, many insureds are not so fortunate. In the majority of cases, if an insured enters into a waiver of subrogation without the insurer’s knowledge, the insurer is well within its rights to deny coverage and leave the insured to its own devices and cover the loss out-of-pocket.
Based on the foregoing, the question now becomes: what if I am presented with a contract that contains a waiver of subrogation? Do I have to reject the contract? Should I demand that the provision be deleted? Should I sign it and hope the insurance company never finds out? NO! The simple answer is to present this issue to your insurer. It is likely that the insurer will enter into an endorsement allowing for the waiver of subrogation. As you may expect, this endorsement will come with an increased premium, as the insurer has to recoup its risk through higher prices. Also, it goes without saying, if you have entered into an agreement with a waiver of subrogation clause and then seek insurance, be sure not to hide this from the insurer, as the gambit could result in denial of coverage in the event of a claim. Another easy solution is to consult an attorney specializing in this area who understands the risks involved in these types of waivers and who is able to negotiate with the insurer to ensure you are not left without coverage.

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