



Bulletin

Subrogation Can Spell Trouble

INTRODUCTION

This article addresses loss problems resulting from the operation of subrogation clauses. If an insured waives its insurer's subrogation rights, the insured may have no coverage at all. Waiver of subrogation clauses can be attached to insurance policies to eliminate the potential problems stemming from subrogation.

Caution: Before signing any contract documents that address your firm's insurance coverage relating to a project, have your firm's insurance agent(s) review and approve the documents. Also, before signing any agreement to determine your firm's insurance liabilities and limitations, carefully review (or have your legal counsel review) the general contractors' contracts.

The following provides a few hypothetical examples of problems that can occur involving a variety of insurance coverages.

SUBROGRATION

Electrical Contractor, LLC (ECL) was working at a construction site. Because a worker improperly installed a circuit breaker board, a fire ensued. The fire

caused about \$300,000 in damage to equipment belonging to Rigging, Inc. (RI), another contractor working on the construction project. RI was surprised when its adjuster asked RI to sign papers authorizing RI's insurer to subrogate against ECL. At first, RI refused to sign the subrogation authorization stating that they had paid a premium to have their insurer pay for RI's losses, not to have another contractor pay for their loss.

RI's insurer then referenced the following provision from their insurance contract, American Association of Insurance Services' (AAIS) Contractors Equipment Form IM-7000 Ed 1.0:

Subrogation: If we pay for a loss, we may require you to assign to us your right of recovery against others. You must do all that is necessary to secure our rights. We do not pay for a loss if you impair this right to recover.

Because RI's owner was a friend of the ECL's owner, RI did not want to sign the necessary papers authorizing the insurer to subrogate. However, the company knew that it did not have the resources to pay for a \$300,000 loss, so it agreed to the subrogation authorization.

ECL submitted the subrogation claim to its insurer, fully expecting to have coverage for the subrogation claim. ECL was surprised when its insurer denied the claim. The insurer took the position that the damaged property was in the care, custody, and control of ECL and that, therefore, there was no coverage for the subrogation claim.

ECL did not have any insurance or the money to cover the \$300,000 claim. The subrogation against ECL caused the firm to file for bankruptcy. Several months elapsed between the subrogation filing and ECL's filing for bankruptcy. After the bankruptcy filing, even more time elapsed while the owner of the construction project obtained another electrical contractor to finish ECL's work.

Realizing that subrogation could significantly disrupt the construction process, the project owner had an addendum added to all of the contracts with the contractors for the project. The contract addendum required that all contractors have their insurers waive their subrogation rights. Once this change had taken place, the project owner did not expect any more problems resulting from subrogation.

WORKERS COMPENSATION SUBROGATION WAIVER

Shortly after the contracts had been amended not to allow subrogation by the insurers of any contractor on the job, a ready-mix cement truck backed over a worker's leg. Nothing happened while the injured worker's leg was healing. As soon as the worker's compensation claim was closed, a subrogation claim was presented against the ready-mix cement firm. The ready-mix cement firm objected saying that the construction contracts did not allow subrogation.

The workers compensation insurer replied that the subrogation waiver in the construction contracts did not apply. The clause from the National Council on Compensation Insurance's (NCCI) Form WC 00 00 00 A (04/92) that was cited states:

Recovery From Others. We have your rights to recover our payment from anyone liable for an injury covered by this insurance. You will do everything necessary to protect those rights for us and to help us enforce them.

The workers compensation insurer then proceeded with its subrogation claim. While that occurred, the contractors involved asked their insurance agents if there was any way to preclude subrogation by the workers compensation insurer. The underwriter referred them to NCCI's Form WC 00 03 13:

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 the person or organization named in the Schedule. (This agreement applies only to the extent that you perform work under a written contract that requires you to obtain this agreement from us.) This benefit shall not operate directly or indirectly to benefit anyone not named in the Schedule.

When using the Workers Compensation Waiver of Subrogation Endorsement, keep several things in mind. The most important concern is that the waiver applies only to those firms that are listed on the schedule in the endorsement.

For example, suppose that Cement Forms, Inc. (CFI) is working at a construction site where every firm is to waive subrogation. Initially, the insurer will list all of the contractors on the insurance contract. However, as is usually the case during the course of the project when additional contractors will be working at the site, CFI won't be told about the additional contractors and, therefore, they will not be added to the list of contractors against whom the subrogation rights have been waived.

A typical case might be where one of the original contractors (Carpenter, Inc.) hires a sub-contractor (Trim Finishing Contractor, LLC) to help finish the work. The project owner may not be aware that Trim Finishing Contractor is on the job. Trim Finishing Contractor has not been added to CFI's workers compensation policy waiver of subrogation endorsement. A CFI employee is negligently injured by a Trim Finishing Contractor employee. After paying the loss, CFI's insurer will subrogate against Trim Finishing Contractor.

Not having every contractor on the site added to all of the construction contractors' workers compensation waiver of subrogation endorsements will always be a concern.

COMMERCIAL AUTO SUBROGATION WAIVER

Assume that both Cement Forms and Redi-Mix Cement (RMC) had signed the contract waiving the subrogation rights of their insurers. One of Cement Forms' employees left some steel forms lying in the path of an RMC truck. A wheel hit one of those forms. The form twisted upward and sliced the oil pan on the large cement truck. In seconds, all of the engine oil drained out of the motor and onto the ground. The motor was

running at full speed and was under a full load. Because all of the oil had leaked out and the pistons were running in dry cylinders, the engine began to knock very loudly. Even though the truck driver turned off the engine as soon as he was aware that something was wrong, the engine was damaged at a cost of \$20,000.

RMC's insurer paid for the loss and immediately began subrogation proceedings. Upon the instigation of the subrogation proceedings, RMC's insurance agent objected, quoting the following from RMC's Insurance Services Office's (SO) Business Auto Policy, Form CA 0001 1293:

Transfer of the rights of recovery against others to us. If any person or organization to or for whom we make payment under the Coverage Form has rights to recover damages from another, those rights are transferred to us. That person or organization must do everything necessary to secure our rights and must do nothing after accident or loss to impair them.

Upon checking the construction contract documents, it was determined that RMC had not signed the contract addendum, whereby the contractors signed the subrogation waiver clauses. RMC said that it would have no problem with signing the subrogation waiver immediately. After learning of this, the insurer told RMC that if it signed the waiver after the loss, there would be no coverage for its loss.

COMMERCIAL GENERAL LIABILITY COVERAGE FORM

As is typical at some construction sites, there were curious passersby (straw bosses) who would watch the

construction work. General Contractor, Inc. (GCI) had signed the subrogation waiver. At the same time that GCI was lifting something with a large crane, a truck for Lumber Yard, LLC was delivering lumber to the site. The truck came too close to the crane, hitting it and causing the crane to drop part of its load. Part of the load fell outside the fence that marked off the construction site. Several of the “straw bosses” standing outside the fence were injured and brought claim against GCI. Upon paying the loss, GCI’s insurer proceeded to process a subrogation claim against Lumber Yard. GCI objected to the subrogation.

Here is the clause from ISO’s Commercial General Liability Coverage Form CG 0001 01 96 that the adjuster quoted when explaining why they could subrogate:

Transfer of Rights of Recovery Against Others to Us. If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The injured must do nothing after the loss to impair them. At our request, the insured will bring “suit” or transfer those rights to us and help us enforce them.

The subrogation waiver that had been signed applied to the contractors working on the job. Contractors such as electricians, mechanicals, heating and air conditioning, and carpentry who were on the site almost full-time had signed the subrogation waiver. No one thought to have the suppliers also sign the subrogation waiver as well. On any given day, one or more firms delivered items to the construction site. They had not signed the subrogation waiver. Various common carriers delivered material to the site. Some of these

trucking firms were bringing just one or two packages of materials. Others were bringing very large loads. For instance, the common carrier who was delivering the heating and air conditioning equipment brought in two full truckloads of equipment for the construction project.

The point is that, at many construction sites, there will be one or more firms that have not signed any waiver of subrogation form. It is because of this type of situation that insurers will not give a blanket waiver of subrogation. This leads us to the wording on a Commercial General Liability (CGL) coverage form endorsement.

Subrogation waived prior to a loss is permitted by the Commercial General Liability coverage form endorsement. Interestingly enough, there is also an endorsement for the Commercial General Liability coverage form that can be used to waive the subrogation clause. Waiver of Transfer of Rights of Recovery Against Others to Us (Form CG 2402 1093) can be added to the commercial general liability coverage form, and the wording follows:

We waive any right of recovery we may have against the person or organization shown in the Schedule above because of payments we have made for injury or damage arising out of your ongoing operations of your work done under a contract with that person or organization and included in the products completed operations hazards. This waiver applies only to the person or organization shown in the Schedule above.

Waiver of subrogation prior to a loss is permitted by the Commercial General Liability coverage form. That waiver depends upon a contract separate from

the CGL policy. It is possible that the contract waiving the subrogation is flawed in some way, thereby allowing an insurer to subrogate despite the contract. Attaching an endorsement, CG 2404, to the Commercial General Liability coverage form is a better way. Although the subrogation waiver will still be in the construction contracts, having subrogation waived by attaching an endorsement to a policy is a way of reinforcing or precluding any error(s) in the construction contract waiver of subrogation wording.

SUBROGATION WAIVER ENDORSEMENT

There are separate subrogation waiver endorsements for workers compensation and commercial general liability coverage forms. However, none of the other forms has a specific form to waive subrogation. While this may be very difficult to accomplish, it is recommended that a specific waiver of subrogation endorsement be attached to every insurance policy for every contractor at the construction site. Insurers have blank endorsements that they can use to accomplish this.

This is a partial list of the types of insurance policies that may need to be endorsed with a subrogation waiver endorsement: builders risk, installation floater, contractors' equipment, workers compensation, automobile umbrella, and commercial general liability.

UMBRELLA

If your insurer has an umbrella endorsement for waiving subrogation, by all means use it. Should your umbrella carrier not have a specific waiver of subrogation endorsement, it is suggested that they use a blank endorsement and wording that tracks

with the CGL's waiver of subrogation form.

UNDERWRITING

Although some underwriters are reluctant to provide a waiver of subrogation endorsement, there are several reasons why providing one is not an underwriting problem. As late as the early 1970's, subrogation was not a normal procedure in the insurance business. Subrogation was rarely, if ever, carried out. No underwriter considers subrogation while underwriting an account. Underwriters do not think, "Any loss that this account sustains can be subrogated so, therefore, I will not have a bad loss ratio on this account." With subrogation clauses in operation, underwriters are just as likely to be subrogated against as they are to subrogate against someone else. Many of the coverage forms' subrogation clauses already allow subrogation rights to be waived prior to a loss. Providing coverage by referring to a contract other than the insurance policy can provide difficulties in interpretation. Adding a subrogation waiver endorsement simply puts the identical feature directly into the insurance contract. If waiver of subrogation applies to all of the contractors at a construction site, an underwriter's exposure has not changed.

SUMMARY

- Subrogation exposures exist at construction sites because many different firms work in close proximity.
- It is possible to have a subrogation claim not be covered by insurance.
- An uncovered subrogation claim can bankrupt a contractor.
- Construction can be delayed

- when a contractor goes bankrupt.
- Many insurance policies allow waiver of subrogation if the waiver is in writing prior to the loss.
- Workers compensation and commercial liability contracts have waiver of subrogation endorsements that can be added to their respective contracts.
- It is recommended that a waiver of subrogation endorsement be added to every policy for every insured at a construction site.

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