

Construction Contracts: Waivers of Subrogation, Indemnification, and Contribution

Complexities and Pitfalls of Waiver Provisions for Contractors, Owners, and Insurer

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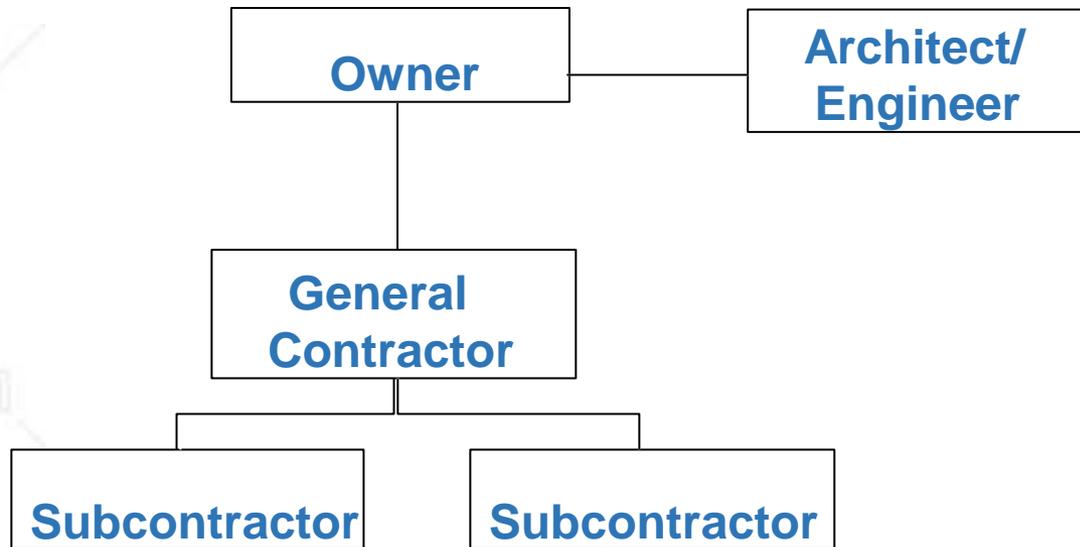
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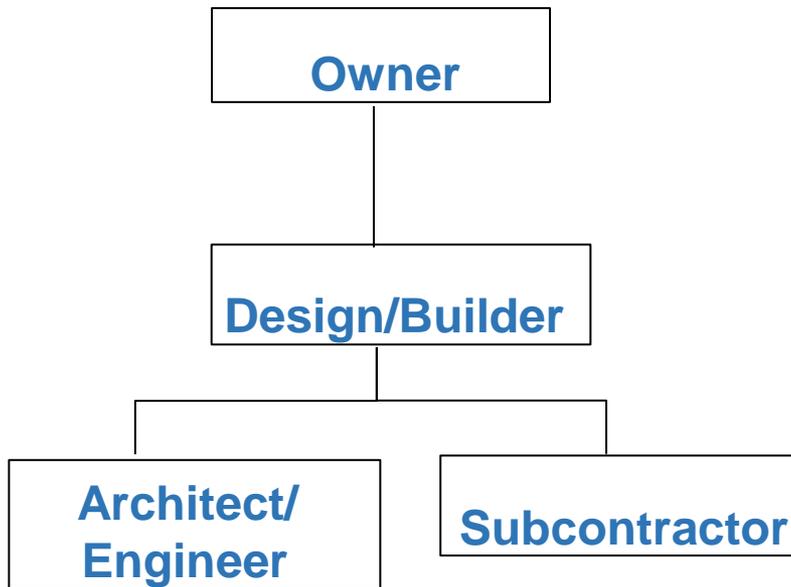
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Risk allocation: Design-Bid-Build:



Risk allocation: Design-Build:



Construction Contract Risk Transfer Methods



- Objectives for Managing Risk in Contracts:
- Agreed distribution of liabilities between parties;
- Clear and unambiguous terms and conditions;
- Appropriate interplay between insurance programs and risks identified/distributed in the contract.

Interaction Between Insurance and Indemnification

Risk allocation is the common thread between insurance and indemnification – they should work in tandem but are separate concepts.

- Insurance shifts risk of costs and liability from the insured to its insurance company.
 - Claim should be made to the insurance company.
 - However, if contracting party failed to procure proper insurance, may result in breach of contract claim against contracting party.
- Indemnification shifts risk of costs and liability from one contracting party to another.
 - Claim should be made to the indemnitor.

Risk-shifting provisions in construction contracts:

- Insurance requirements:
 - Must fit project insurance program; (OCIP, CCIP, traditional where each party procures its own insurance);
 - Lines of coverage;
 - Limits;
 - General requirements.
- Indemnity provisions:
 - Limited (comparative);
 - Intermediate;
 - Broad.
- Site conditions:
 - Differing site conditions;
 - Haz Mats



Other risk-shifting provisions in construction contracts



- Mutual waiver of consequential damages;
- Liquidated damages;
- Warranties and guarantees;
- Damages for delay;
- Pay when paid; pay if paid clauses;
- Limitations of liability for discrete issues (i.e., LDs cap, LEED damages cap).

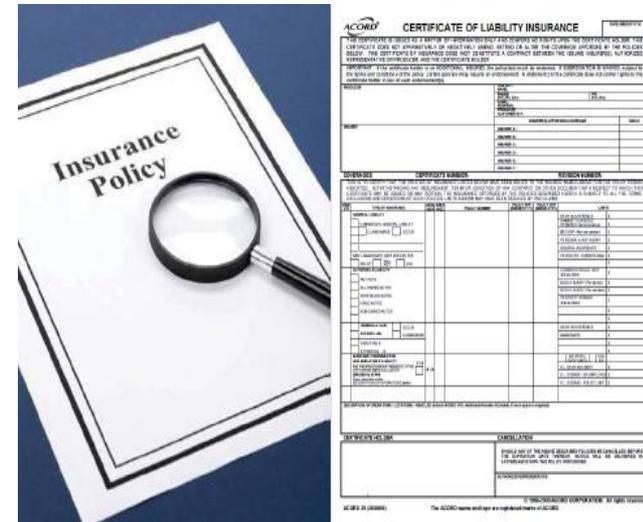
Considerations: Scope of Work

- What services are being performed?
- Are they “core” services offered by the performing party as a matter of course?
- What are the key risks exposures associated with the work performed?
- Are the key risk exposures covered by insurance?
- Will any work be subcontracted?
- Are there any unique hazards or exposures?



Insurance policies: applicable coverage lines

- OCIP/CCIP/SCIP Programs;
- Commercial General Liability (“CGL”);
- Commercial Automobile Liability;
- Workers’ Compensation;
- Excess/Umbrella Liability (typically follows form over underlying CGL, Workers Comp, and Auto);
- Builder’s Risk/Property;
- Professional liability (design professionals; contractor and subcontractor engineer-sealed or stamped submittals such as shop drawings);
- Pollution Liability;
- Cyber;
- Other.



Insurance policies: Key questions:

- Who buys the various coverages?
- Who is an insured?
 - Who is an additional insured (AI)?
 - Is AI coverage primary?
- When does coverage end?
 - Project completion?
 - Substantial completion?
 - For CGL and Excess/Umbrella insurance: how long is completed-operations coverage maintained?



Indemnification

- A contractual commitment to reimburse another party for loss, damages or liability.
- Risk-shifting device where one assumes someone else's responsibility.



Indemnification: Who can/should be indemnified?

- Typically upstream parties, but depends on contract terms;
- Owner, JV partner, Lender, Ground Lessor, others;
- Consider terms giving or receiving;
- Beware of open-ended language, such as “Representative,” “Agent,” or “Designee.”



Indemnification: What does the indemnification cover?

- Depends on contract terms
 - BI/PD
 - Economic loss
 - Infringement of IP rights
 - Breach of warranty or representation
 - Third-party v. first-party claims?
 - Capped v. uncapped?



Indemnification

- Indemnity for receiving party's own/sole negligence?
 - Depends on contract terms, but also applicable state law;
 - Most jurisdictions bar indemnification of another's gross and/or sole negligence.
 - Some states have extended this to additional insured coverage.
- Consider causation language.



Types of Indemnity Agreements:

- **Broad Form Indemnity**: The indemnitor agrees to be responsible for any and all liability arising out of the contractually-provided products or services, including liability that is the result of the sole negligence of the indemnitee. Most states prohibit, or severely limit, the use of broad form indemnity provisions in construction contracts.
- **Intermediate Form Indemnity**: The indemnitor agrees to be responsible for liability arising out of the contractually-provided products or services that is the result of the indemnitor's sole fault or negligence, as well as liability for which the indemnitee and indemnitor are jointly at fault. The indemnitor is not responsible for liability incurred as a result of the sole fault or negligence of the indemnitee.
- **Comparative (Limited) Form Indemnity**: The indemnitor agrees to be responsible for liability arising out of the contractually-provided products or services that is the result of the indemnitor's fault or negligence, but only to the extent of such fault or negligence. This type of agreement mirrors the obligations imposed by tort law.
- **Anti-indemnity statutes may limit the scope of an indemnity clause or, even worse, make it unenforceable.**

AIA A201 (2017) Indemnity Provision:

§ 3.18.1 **To the fullest extent permitted by law**, the Contractor shall indemnify and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses, and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss, or expense is attributable to **bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent** caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them, or anyone for whose acts they may be liable, **regardless of whether or not such claim, damage, loss, or expense is caused in part by a party indemnified hereunder**. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity that would otherwise exist as to a party or person described in this Section 3.18.

Sample Comprehensive Indemnity Provision:

To the fullest extent permitted by law, the Contractor shall defend, indemnify and hold harmless the Owner, Lender, Lender’s construction consultant, Architect, consulting engineers, Owner’s Representative, and their respective agents and employees (the “**Indemnified Parties**” and each an “**Indemnified Party**”) from and against any and all claims, damages, fines, penalties, losses and expenses, including reasonable attorney’s fees and expert witness fees (“**Indemnified Claims**” and each an “**Indemnified Claim**”), arising, directly or indirectly, from the performance of the Work, **breach of this Contract, or a Contractor Party’s negligence or willful misconduct with respect to the Project**, provided that such Indemnified Claim is attributable to bodily injury, sickness, disease, or death or to injury to or destruction of tangible property (other than the Work itself **to the extent amounts are recovered pursuant to builder’s risk insurance**), regardless of whether or not such Indemnified Claim is caused in part by an Indemnified Party.

Sample Comprehensive Indemnity Provision: Economic Loss Indemnification



The Contractor shall also indemnify, defend, and hold harmless the Indemnified Parties from and against Indemnified Claims for economic loss (that is, Indemnified Claims not attributable to bodily injury, sickness, disease, or death or to injury to or destruction of tangible property), but only to the extent such economic loss was caused by a breach of this Contract or a Contractor Party's negligence or willful misconduct with respect to the Project, regardless of whether such Claim is caused in part by an Indemnified Party.

Sample Comprehensive Indemnity Provision: Catch-all Provision:

Such obligations shall not be construed to negate, abridge, or otherwise reduce any other right or obligation of indemnity which would otherwise exist as to any Indemnified Party. **Nothing herein shall be construed to require the Contractor to indemnify an Indemnified Party for an Indemnified Claim caused by or resulting solely from that Indemnified Party's own negligence.** It is agreed that with respect to any legal limitations now or hereafter in effect and affecting the validity and enforceability of the indemnification obligation under this Section _____, such legal limitations are made a part of the indemnification obligation to the minimum extent necessary to bring Section _____ into conformity with the requirements of such limitations, and as so modified, the indemnification obligation shall continue in full force and effect.

Tips for Drafting Solid Indemnity Clauses

- “To the fullest extent permitted by law”;
- Do not run afoul of state-specific statutory anti-indemnity provisions;
- Include defense/indemnification obligation for allegations, even if disputed by indemnitor;
- Do not forget to consider indemnity for economic loss – this may require revisions to the waiver of consequential damages provision;
- Make first-party damages, or damages sustained directly by the indemnitee, a part of the indemnity agreement;
- Include language that allows for fees and costs associated with enforcing the indemnity obligation.
- Don’t commingle your indemnification clause with insurance requirements.

What is an additional insured?



- Additional insured status provides a party with the benefits of insurance coverage obtained by another party, usually under the latter's commercial general liability (CGL) insurance.
- Historically, the scope of coverage was determined by:
 - the policy's additional insured endorsement;
 - and other policy terms.
- Now, parties must look to:
 - the policy's additional insured endorsement;
 - other policy terms; and
 - **the underlying contract.**

Why Seek Additional Insured Status?

- Shifts the risks to the party that is undertaking the activities.
- Reinforces indemnity provisions by providing the additional insured with direct rights under the indemnitor's policy.
- Provides the additional insured with an immediate defense (without affecting policy limits) by the named insured's insurer, rather than seeking reimbursement of defense costs from an indemnitor or seeking a defense under its own coverage.

Additional Insureds: Disadvantages

- No control over the defense or selection of defense counsel;
- Limits must be shared among all insureds, such that payment of judgment or settlement as to one party may use up the applicable limit of insurance in a liability policy, thereby ending insurer's right and duty to defend;
- Additional insured often has no business relationship with Named Insured's carrier;
- Policy may not provide complete indemnity or may provide less than contracted for limits;
- Additional insured must comply with conditions of policy in order to obtain and retain coverage, possibly including notice and cooperation.



Tips For Drafting Additional Insured Requirements

- Specify the form endorsements through which the additional insured coverage is provided.
- Require that the additional insured coverage be “primary and non-contributory.”
- Understand the difference between named insured, additional named insured, and additional insured.
- Do not rely on certificates of insurance to confirm additional insured status – require copies of policies and endorsements.

Additional Insured (AI) coverage: Reminders

- Is AI coverage primary?
- Different AI endorsements provide different coverage:
 - 1985 – Gold Standard – Broad (includes “arising out of” language, which covers sole negligence)
 - 2001 – (preserves “arising out of” language; splits completed operations coverage)
 - 2004 - Intermediate Forms (includes “caused, in whole or in part, by” language; removes sole negligence)
 - 2013 - Limited Forms (limits coverage to “extent permitted by law” and “contract requirement or agreement”)

Drafting Tips to Overcome 2013 ISO Endorsement Issues

- Include the following two clauses in the additional insured requirements section:
 - *Coverage for the additional insured shall be at least as broad as that afforded the first named insured.*
 - *The limits of insurance provided to the additional insured shall be the greater of: (i) those set forth in the contract, or (ii) the full per occurrence limit set forth in the policy.*



Contribution

- Rarely expressly addressed in construction contracts
- Requires joint liability for a single loss (but not necessarily liability under the same legal theories)
 - Ex: contractual liability and negligence
 - *See, e.g., City of Willmar v. Short-Elliott-Hendrickson, Inc.*, 512 N.W.2d 872, 875 (Minn. 1994).

Minimizing risk: Don't overlook the obvious



- **For Owners/Developers:**
 - Review project risks;
 - Get parties under contract early;
 - Ensure that the contract's risk allocation provisions, including insurance requirements, properly address and allocate those risks;
 - Don't use "the clause from the last contract."
 - Confirm that insurance is in place; don't rely on certificates of insurance.

Minimizing risk: Don't overlook the obvious



- **For Contractors:**
 - Require signed subcontracts;
 - Get certificates of insurance;
 - Require that subcontractors provide additional insured coverage;
 - Make sure any required insurance meets the contract requirements.

Minimizing risk: Don't overlook the obvious



- **For Subcontractors:**
 - Require signed sub-subcontracts;
 - Get certificates of insurance;
 - Require that sub-subcontractors provide additional insured coverage;
 - Make sure any required insurance meets the contract requirements.

Waivers of Subrogation

How they work, drafting tips, and pitfalls to avoid

The Basics

- Subrogation: If you pay for someone else's loss, but you didn't cause the loss, you might be entitled to their right of recovery from the culpable party.
- NOT just a voluntary payment—must be pursuant to contract or **necessary** to protect legal/economic interest
- Examples
 - Insurance company pays losses for its insured
 - Owner pays prime contractor's sub (but only if non-voluntary)

Why waive subrogation rights?

- Provide certainty about risk allocation
 - Ensure that risk of construction defects is appropriately allocated.
 - Curtail follow-on litigation.

Best practice: 2-part waiver (waivers in both construction contract and insurance policy)

Contract

- Waiver of the parties' rights of recovery
- Example: AIA-A201 general conditions § 11.3.5:
 - "Owner and Contractor waive all rights against...each other and any of their subcontractors...for damages...to the extent covered by property insurance."

Policy

- Waiver of the insurer's right of subrogation
- Example
 - "If the insured waived any rights of recovery against any person for any payment we make under this Coverage Part, we also waive that right, provided the insured waived its rights before the injury or damage."

What if contract has waiver but policy doesn't?

- If insured waived its own rights:
 - Insurer probably has no right of subrogation.
 - *See, e.g., N. Am. Specialty Ins. Co. v. Payton Constr. Corp.*, 953 N.E.2d 233, 235 (Mass. App. Ct. 2011).
 - But did policy prohibit waiver?
- If insured didn't waive its own rights, but tried to waive insurer's:
 - Most states: Court should enforce parties' intent that insurance cover risks.
 - *See, e.g., Acadia Ins. Co. v. Buck Constr. Co.*, 756 A.2d 515, 519 (Me. 2000).
 - A few states: As long as insurer didn't consent to purported waiver, insurer can still enforce insured's right of recovery.
 - *See, e.g., St. Paul Fire & Marine Ins. Corp. v. Amerada Hess Corp.*, 275 N.W.2d 304, 308 (N.D. 1979).

What if: Policy prohibits waivers

- Waiver of insurer's right of subrogation
 - Pre-loss waiver is probably valid.
 - *See, e.g., Trinity Universal Ins. Co. v. Bill Cox Constr., Inc.*, 75 S.W.3d 6, 10-11 (Tex. App. 2001).
- Waiver of insured's right of recovery
 - Insurer probably can't enforce rights that insured waived.
 - *See, e.g., Md. Cas. Co. v. Trane Co.*, 742 A.2d 444, 446 (Conn. Super. Ct. Aug. 10, 1999).
- Waiver by insured may violate conditions of coverage.
- Insurer may have breach-of-contract claim against insured.

Scope of waiver

- Often limited to claims covered by insurance
 - Example: AIA-A201 general conditions § 11.3.5: Waiver applies to “damages...to the extent covered by property insurance.”
- Does waiver apply to insurance that the contract doesn’t require?
 - Depends on wording
 - Waiver can still be valid
 - *See, e.g., Acuity v. Interstate Constr., Inc.*, No. 2007-P-0074, 2008 WL 625097, *11 (Ohio Ct. App. March 7, 2008) (waiver was valid as to non-required insurance where waiver covered damages “if, after final payment, property insurance is to be provided on the completed project”).

Anti-subrogation rule and waivers

- **In general: Insurer can't subrogate against its own insured**
 - Adopted in most states
 - Includes additional insureds
- **Named insureds/additional insureds should still obtain waivers of subrogation**
 - Loss exceeding policy limits
 - Loss outside coverage scope
 - Loss outside scope of additional-insured coverage

Subrogation versus indemnification

- Does an indemnification clause impair the right of subrogation?
 - Short answer: No
 - An insured impairs subrogation rights by releasing a tortfeasor from liability.
 - Indemnification doesn't extinguish liability; it may change the payor.
 - *See, e.g., Baloise Ins. Co. v. Sw. Freight of San Antonio, Inc.*, 698 F.Supp. 674, 674 (S.D. Tex. Nov. 11, 1988).

Recent cases and hot topics

Insured's own negligence, real party in interest, and more

Insured's own negligence

- Waiver can be viewed as exculpatory provision for defendant's own negligence
- Most courts have upheld
 - Doesn't absolve defendant of liability—just shifts risk as to portion of damages covered by property insurance.
 - *See, e.g., Intergovernmental Risk Mgmt. v. O'Donnell, Wicklund, Pigozzi & Peterson Architects, Inc.*, 692 N.E.2d 739, 745 (Ill. App. Ct. 1998).
 - Purpose of prohibiting exculpatory clauses is to protect innocent third parties (ex: construction workers); shifting risk doesn't leave them without a remedy.
 - *See, e.g., Best Friends Pet Care, Inc. v. Design Learned, Inc.*, No. X06CV000169755S, 2002 WL 1949202, *2 (Conn. Super. Ct. July 22, 2002).

Insured's own gross negligence

- Waiver may still be valid:
 - Public interest in avoiding costly litigation
 - *See, e.g., Lexington Ins. Co. v. Entrex Commc'n Servs.*, 749 N.W.2d 124, 131 (Neb. 2008).
 - Not all states agree:
 - *See, e.g., Mass. Bay Ins. Co. v. Bilbrey Constr., Inc.*, No. 10-CV-94, 2010 WL 11583179, *6-7 (S.D. Ohio Nov. 15, 2010) (applying Ohio law).

Work versus non-work

- Scenario: Waiver of rights of recovery applies to “damages covered by insurance applicable to the Work.” Damages exceed scope of work, but all damages are covered by some form of insurance.
- Does waiver apply to damages beyond the scope of work?
 - Majority position: *Bd. of Comm’rs v. Teton Corp.*, 30 N.E.3d 711, 718 (Ind. 2015).
 - Minority position: *Copper Mountain, Inc. v. Indus. Sys., Inc.*, 208 P.3d 692, 699-700 (Colo. 2009).

Releases that impair right of subrogation

- Scenario: Insured suffers loss, is compensated by insurer, but sues tortfeasor. Insured and tortfeasor settle and insured releases all claims against tortfeasor.
- Does the release impermissibly impair insurer's right of subrogation?
- Does it matter if the tortfeasor knew about insurer's interest?

See, e.g., Commercial Union Ins. Co. v. Blue Cross & Blue Shield, 540 So.2d 1368, 1370 (Ala. 1989).

Real party in interest

- Scenario: Insured is sued, insurer accepts defense, and insured wants to assert counterclaims.
- If the insurer is the real party in interest, does the insurer's waiver of subrogation bar those counterclaims?

Wilk v. Columbia Univ., 171 A.D.3d 570, 571-72 (N.Y. App. 2019).

Third-party claims

- Scenario: Owner and GC waive rights of recovery. Property is damaged. Owner sues someone outside the chain of construction contracts (ex: security company, property manager), and that person sues GC for contribution and/or indemnity.
- Does Owner/GC waiver bar third party's claim?

Gables Constr., Inc. v. Red Coats, Inc., 207 A.3d 1220, 1237-38 (Md. App. 2019).

AI coverage and the anti-subrogation rule

- Scenario: Policy recognizes party as AI “as its interests may appear.” AI causes damage to the property of other parties.
- Can insurer subrogate against AI for damage to property in which AI has no interest?

Certain Underwriters at Lloyd’s, London v. Sunbelt Rentals, 790 Fed.Appx. 723, 727 (6th Cir. 2019).

Questions?

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