



Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 68:
**Mind the Back Door: A Discussion of Insurer
Subrogation Rights and Contractual Waiver of
Subrogation Provisions**

By [Lynda Bennett](#), [Eric Jesse](#)
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Eric Jesse: Hi, I'm Eric Jesse, partner in Lowenstein Sandler's Insurance Recovery Group. And welcome to Don't Take No for an Answer. Today, I'm joined by my partner and co-host of Don't Take No, Lynda Bennett. Welcome, Lynda.

Lynda Bennett: Hey, Eric. Good to have the band back together. What are we talking about today?

Eric Jesse: All right, well, we're going to talk about a potential policyholder pitfall and that is waiver of subrogation issues that come up in the insurance context and how they intersect with contractual requirements. So, let's set the table. Tell our audience what is subrogation?

Lynda Bennett: So at the highest level, subrogation is an equitable remedy that is intended to have the party that is ultimately responsible for a loss that has been incurred at their doorstep. So this is a concept that exists in the common law and any party that's involved in a dispute where there's been a loss has the ability to pursue subrogation against other parties that are responsible for the loss. But subrogation can also be a contractual right.

And Eric, as you said in setting the table for this discussion today, we see this all the time in two ways. One, in the insurance policy itself. Every insurance policy that gets issued; you will see a section that says the policy holder does not have the right to prejudice the insurance company's subrogation rights vis-à-vis a third party. The second way we see it coming up in a contract is sometimes if you have a master services agreement, if you're working on a large construction project, the parties to those contracts will ask, one or the other, or both of them will say, "Waive any subrogation rights that you have against me."

Eric Jesse: Yeah, no, that's right. And when I think about subrogation or try and describe it, it's often stepping into the shoes of the plaintiff that has rights against the tort fees. And so the insurance company, they step into the shoes of their

policy holder and try to recover when they make a claim payment. So will insurers agree to include a waiver of subrogation clause in their policies? How does that work?

Lynda Bennett: So insurers will agree to do that and there's one of two ways that you can do that. One way is on a project-by-project basis. You can go and ring the doorbell of the insurance company and say, "Hey, I'm about to enter into this contract. The other side has asked me to agree waiving any subrogation rights that may flow from this contractual relationship." And the insurance company can either say yes or no. If they say yes, they'll add a specific endorsement to your policy. And so for that particular contract they will waive that provision I talked about earlier that says you can't prejudice our subrogation rights, that's been waived. The more common way that we see it is, and again this particularly arises in the construction defect space, the commercial general liability policy may have a blanket waiver of subrogation endorsement that says anytime you are required by a written contract to waive subrogation rights, we, the insurance company, will agree to that and be bound by that.

Eric Jesse: Yeah, the policy that's near and dear to my heart in terms of reps and warranty insurance, there the R&W insurers will include a waiver of subrogation against the seller party, which obviously is critical to make R&W insurance work because it's ultimately to make sure in part that the seller has limited recourse. But there is the exception for seller fraud. So that's the only time an R&W insurer will have recourse or subrogation rights against a seller.

Lynda Bennett: I should also mention, so construction, rep and warranty, we see this very often. We also see it very typically in the landlord tenant space when you're looking at the lease. That's something that is generally asked for. And we're also starting to see it in certain cyber context when there's master services agreements and some things of that nature.

Eric Jesse: Yep, absolutely. And in the landlord tenant situation, when the waiver of subrogation is requested for a property policy, it can be a little different because there isn't that standard waiver of subrogation provision or endorsement that you're talking about. So you need to make sure that your property policy has language that allows a tenant, for example, to give a release essentially to the landlord if insurance steps in. So that's key language to look for in the policy before giving that waiver in the lease agreement. So what is the cost, if any, associated with getting a waiver of subrogation or having the carrier give up that right?

Lynda Bennett: So this is a little hard to pin down, and you just kind of touched on it. In certain areas, the insurance company may just say no. And we've seen a little bit more pushback in that landlord tenant situation. But I do believe that there is a cost, and I keep going back to where I've seen this issue most prominently, and that's in the construction defect space. It's hard to pin down, though. There's not a line-item dollar that we can associate with that typically. Rather, I think it gets baked into the overall premium pricing because when you've agreed on a blanket basis, as I said before, a blanket waiver of subrogation endorsement on there, that's reflecting that the insurer is taking on a greater level of risk because we've just given away the ability for the

insurer to pass a claim through to the ultimately responsible party. So I can't give you a precise math on that, but it's not without cost because the carrier's taking on a greater level of risk.

Eric Jesse: All right. I guess it's the "it depends" answer, the typical lawyer.

Lynda Bennett: We try to avoid that, but on this one, it's unavoidable, unfortunately.

Eric Jesse: Of course. So what do policy holders need to be careful about when they're seeking a waiver of subrogation? Can you just accept what's coming from the carrier? What are the pitfalls or issues that policy holders need to be attuned to?

Lynda Bennett: So I'm going to give you the most classic example, and just this week the example came up again, and that is when you're giving a waiver of subrogation. Now we're not talking about the insurance policy in the first instance. We're talking about that contract that's been entered and the parties have agreed to waive subrogation. I worked on a claim many, many years ago where there was a corporate entity that had a very complex organizational chart. And so the waiver of subrogation clause was given by one of those corporate entities, but it didn't go all the way up the chain to the very top of that corporate organizational chart. It was a construction case. They worked on the case. And two days before the plant was done it exploded.

And the great news was, it was a joint venture, they put the claim in to the joint venture insurer, the joint venture insurer paid the claim and then immediately initiated a subrogation action against one of the corporate entities that was up at the top of the corporate chart. So that's a long way around to say you better be really careful when you're contracting with another party to make sure that those waiver of subrogation rights apply to every corporate entity. Sometimes you have an LLC sitting over here, it's a sister company. You got to be super-duper careful that that waiver of **subro** is going to extend to every corporate entity that is going to be touching this contract.

Eric Jesse: Yeah, I guess that means you need to have the long language. It's not just the insured, but any affiliates or representatives or agents, all that good language in there.

Lynda Bennett: And as I said, I had an example of this just this week that came up in the context of a cyber claim now, where there was a parent and a subordinate company where data was kept on the subordinate company's server. The main company had a security breach, put it in, and now the cyber insurer that issued to the main company had the ability to go after the affiliated company because there wasn't a waiver of subrogation there.

Eric Jesse: So what's the downside to agreeing to a waiver of subrogation provision in a contract if you don't tell your insurer about it?

Lynda Bennett: Yeah, we have big problems if you sign that master services agreement without telling your insurer and certainly without first checking your policy to

see if it has that blanket form waiver, a subrogation provision that I talked about earlier. Because in your insurance contract, every one of these has the provision in it that says you are not permitted to prejudice the insurer's rights of subrogation. So if you don't tell your carrier about it, you agree to it in that contract, you will not get coverage for your claim potentially, even if it's otherwise fully covered. If you have showed the carrier that you've waived their subrogation rights, they can invoke that provision to deny your claim. The other thing that you need to do is make sure that the insurance provisions in the contract sync up with that insurance coverage that's secured. You've got to make sure either that you've got for that particular contract or the broad form waiver provision.

Eric Jesse: Yeah, I mean, I think what it comes down to on these, these are, I think in many cases, just easily avoidable issues. You talked about if you ask your carrier for the waiver of subrogation endorsement on the GL policy because it's required in a contract or being required, they'll oftentimes provide it. So these are easily avoidable things that need to be top of mind for policy holders.

Lynda Bennett: Absolutely.

Eric Jesse: So now what are we actually talking about here? Does all this really matter? Do insurers actually exercise their subrogation rights?

Lynda Bennett: Absolutely, yes. As I mentioned, I've seen this issue many times in construction, in property damage claims, product liability claims, and now as I mentioned before, cyber insurers. And I'm really seeing a lot of subrogation activity in that cyber space because insurers are just getting swamped with claims and they're looking to ultimately, as I said at the top in defining what subrogation is, they want to leave the cost of the losses at the doorstep of the party that truly caused that loss. And cyber's the perfect example of it. When your data is being stored on somebody else's server or you bring somebody in, one of the classic examples was there was a huge security breach, I think it was for Target, where they brought in an HVAC vendor who unwittingly created the opening that allowed for the security breach to take credit card information for all of Target's customers. Target was able to get coverage for their claim and then the cyber insurers went after that HVAC vendor hard.

Eric Jesse: I have to agree. I get a report of all the lawsuits that are filed in New Jersey on a daily basis, and oftentimes you see the plaintiff's caption, it's an insurance company, as sub-rogee for the insured. So insurers absolutely press those claims. The one thing I'll say just on the reps and warranty front that we often see is I talked about the waiver of subrogation against the seller, except in the case of seller fraud. But when buyer and seller are getting together to resolve an issue or pay out a lesser claim under a get access to the escrow, the sellers often want that blanket release. And so that's an issue where policy holders need to be very, very careful.

And on this point, I was at a reps and warranty insurance conference where this issue came up and it was good to see one of the brokers on a panel say, "Insurers should not impede that type of release." Why? Because in many cases, at least in that space, the subrogation claim isn't being pressed. All

right, so what should a company do if they were supposed to waive their subrogation rights, but they did not?

Lynda Bennett: So what typically happens here is the claim will get paid and the counterparty to your contract will then be contacted by the insurance company, after they've paid the claim on your behalf, they're going to get contacted by the insurance company and that counterparty is immediately going to come back to you and say, "Hey, you breached our contract by not getting the waiver of subrogation."

In that circumstance, I want to talk a minute about what the insurers are usually, as a practical matter, what are the insurers looking for after they've paid that claim on your behalf? Well, what they do is they go out and they hire lawyers to handle these cases. They're generally not looking for full recovery because the insurers understand that this is an equitable remedy. A court may decide, and there is case law in certain jurisdictions that says, "Yeah, an insurer doesn't get to turn around and pass this back through to the contracting party." It's an equitable remedy. So a lot of times they'll hire law firms that will take these cases on a contingency basis. And so one of the pathways that's available to clients early on is have a reasonable discussion with them and see if there can be an early resolution, because getting it done for less than full value and doing it without having years of litigation may end up being the best path.

Eric Jesse: All right, some practical advice. So let's wrap things up. What are the key things, the key takeaways that policyholders need to know?

Lynda Bennett: So the first thing is that, as I mentioned, a subrogation right holds real value. And that's why insurers want to preserve it, and contracting parties oftentimes want to eliminate it. So it's really crucially important to request for a waiver of subrogation rights with the insurer and make sure that the terms and conditions of the policy that you have in place allow you to provide that waiver before you agree to it in a contract. And last, and most important of all, subrogation's an equitable remedy. So as I just mentioned, it's often best to try to resolve it through a careful and ideally early negotiation if you have those missteps and don't follow the first two pieces of advice.

Eric Jesse: All right. Well, thank you for joining us, Lynda, and thank you for listening, everyone.

Lynda Bennett: Thanks, and we'll see you next time.

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