Applying the AIA Document A201’s Waiver of Subrogation Clause to Claims of Post-Construction Property Loss Due to Construction Defects:

How to prohibit the project owner’s property insurer from recovering post-construction property losses regardless of the theory of recovery

By Erika E. Rose

Imagine that you are the president of a general contracting firm that has been hired to construct a twenty million dollar hotel. You hired a reputable subcontractor to install a three hundred thousand dollar sprinkler system in the hotel. Construction of the hotel was uneventful, and the hotel was completed on-schedule. After the owner tenders its final payment, and months after construction is complete, one of the main sprinkler pipes bursts, causing two million dollars in water damage. To make matters worse, the owner is now claiming that there is pervasive mold throughout the hotel, rendering it unsafe for guests. You are somewhat relieved when you discover that the owner had property insurance which covered the loss. A few months later, however, you learn that the owner’s insurance company has brought a subrogation action against your firm and the subcontractor who installed the sprinkler system.

This situation is all too familiar in the construction industry. Faulty electrical wiring can cause devastating fires months after construction is complete. In this “mold phobic” era, water damage claims are a very serious and costly problem. After a property insurer pays a loss under the owner’s policy, the insurer may bring a suit against any responsible third parties pursuant to the doctrine of “subrogation.”

Many form construction contracts, including The American Institute of Architects (“AIA”) Document A201, contain a waiver of subrogation clause, which, in the past, has barred insurance companies from subrogating against third parties for property damage that occurred during construction.

continued on page 2
AIA Document A201 includes the following waiver of subrogation clause:

11.4.7 Waivers of Subrogation. The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect’s consultants, [certain] separate contractors . . . and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Paragraph 11.4 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary.

A201 Paragraph 11.4 requires owners to maintain property insurance written on a builder’s risk “all risk” or equivalent policy to cover the project until final payment has been made, or otherwise agreed by the parties. A201 Paragraph 11.4.5 provides that if the owner procures separate property insurance covering the completed project through a policy or policies other than those insuring the project during the construction period, the owner agrees to waive all rights in accordance with the terms of 11.4.7 for damages caused by fire or other causes of loss covered by the separate property insurance.

Traditionally, insurance companies have argued that because A201 Paragraph 11.4.5 does not require the owner to purchase property insurance covering the project after construction is complete, the waiver of subrogation provision should only apply when the owner procures a separate policy of insurance specifically covering property damage arising from a construction defect (e.g. a separate builder’s risk policy covering post-construction losses). In a new and developing line of case law, however, several courts have prohibited an owner’s property insurer from seeking subrogation for post-construction property damage, regardless of the type of property insurance procured after completion of construction.

For instance, in Town of Silverton v. Phoenix Heat Source Sys., Inc., 948 P.2d 9 (Colo. Ct. App. 1997), the Town of Silverton contracted with a general contractor for the installation of a new roof on the town hall. To accomplish this goal, the parties prepared and signed a standard AIA contract, which included form A201. More than a year after construction was completed, the hall was damaged by a fire. After the Town’s property insurer compensated the Town for the fire damage, it brought a subrogation action against the general contractor for negligence.

The general contractor argued that the waiver of subrogation clause prohibited the insurer from recovering property damage losses, even though the loss occurred after construction was complete. On appeal, the Colorado Court of Appeals agreed, finding that the waiver of subrogation clause applies to any property insurance applicable to the work, even if that insurance was procured after completion of the project.

In a later case, Colonial Props. Realty Ltd. v. Louder Constr. Co., Inc., 567 S.E.2d 389 (Ga. Ct. App. 2002), the Court of Appeals of Georgia faced a similar claim by a property insurer. In Colonial, the owner hired the general contractor to build an apartment complex. One year after construction was completed, one of the buildings was severely damaged by fire. The property insurer then brought a subrogation action against the general contractor alleging that the apartment complex had been negligently constructed. The insurer argued, inter alia, that the waiver of subrogation clause was inapplicable because the loss occurred after the project was completed.

In rejecting the insurer’s argument, the court concluded that section 11.3.5 of the parties’ contract permitted, but did not require, the owner to obtain a separate policy covering the completed project after final payment. Because the owner obtained a post-construction policy covering the apartment complex, it waived all of its subrogation rights for damages attributable to fire or other perils covered by the separate insurance. However, the court limited its holding to the insurer’s claims for negligence, negligence per se, and breach of contract, finding that the contractor could not exculpate itself from claims of “gross” negligence.

Although the court in Colonial was reluctant to extend application of the waiver of subrogation clause to claims of gross negligence and willful misconduct, recent cases have refused to adhere to this principle. For instance, in Reliance Nat’l Indem. v. Knowles Indus. Servs., Corp., 868 A.2d 220 (Me. 2005), the Supreme Court of Maine held that the waiver of subrogation clause barred the insurance company’s action.
against the contractor despite allegations of willful and wanton misconduct.

In *Midwestern Indem. Co. v. Systems Builders, Inc.*, 801 N.E.2d 661 (Ind. Ct. App. 2004), an insurer brought an action against a subcontractor to recover personal and real property losses as well as lost profits following the collapse of a building addition months after construction was complete. As in previous cases, the owner entered into a standard AIA contract which included Document A201’s general terms and conditions. Consistent with the holdings in *Colonial* and *Town of Silverton*, the Indiana Court of Appeals held that the waiver of subrogation clause prevented the owner’s insurance company from recouping payments paid to the owner for the value of the work.

**Conclusion**

The waiver of subrogation clause is an effective way for contractors and subcontractors to mitigate risk and avoid litigation after construction projects are completed. Careful drafting of construction contracts may prohibit the owner’s insurance company from seeking subrogation against general contractors and their subcontractors. To learn more, please contact your Saul Ewing lawyer.

*Erika Rose is an Associate in Saul Ewing’s Litigation Department and is based in the Firm’s Baltimore office. She focuses her practice on general commercial litigation including construction disputes. Erika can be reached at 410.332.8766, or at erose@saul.com.*

---

**Saul Ewing Sponsors and Participates in Regional Construction Forecast**

*By Erik F. Williams*

On Thursday, April 21, 2005, construction industry executives, investors, and experts convened in the Loews Hotel Philadelphia to attend the "Construction Forecast: Real Estate Development and Construction in 2005 and Beyond." The program, co-sponsored by Saul Ewing and presented by The Greater Philadelphia Chamber of Commerce and the General Building Contractors Association, brought together numerous members of the region’s real estate construction and development communities to discuss relevant issues and topics concerning the economic health of such industries in the Philadelphia metropolitan area. The program featured panel discussions, break-out sessions and a key-note presentation by Joseph Syrnick, President and CEO of the Schuylkill River Development Corporation.

In addition to co-sponsoring the program, Saul Ewing attorneys featured prominently in the program’s agenda. Frederick D. Strober, Partner in the Real Estate Department, Co-Chair of the Construction Industry Service Team, and Philadelphia Office Managing Partner, moderated a panel discussion called “Finding Common Ground: Featuring the Cira Centre -- a Team Project Case Study.” The panel, which included Gerard Sweeney, CEO of Brandywine Realty Trust, Michael Kuntz, Vice President and General Manager of Turner Construction, Mark Celoni, Vice President of Pennoni Associates, Inc., and Taek Park, Assistant Designer of Cesar Peli & Associates, provided an in-depth, behind the scenes look into the construction of the Cira Centre, Philadelphia’s newest landmark skyscraper, which is scheduled for completion in the Fall of 2005.

Program sponsors, panelists and participants all exuded confidence regarding the health of the construction and development industries in the Philadelphia area. As was pointed out by numerous participants, the best indicator of the region’s economic health is the unprecedented preponderance of cranes in the Philadelphia skyline. Indeed, according to data provided by the Center City District, ninety-five construction projects are under way in the Philadelphia metropolitan area, valued at nearly $3 billion. Industry experts noted that the region’s current construction climate is exceptional, both in terms of the number of projects and the total amount of investment. The region has experienced periods of significant construction activity in the past, but 2005 appears to be a high-water mark for commercial, residential, educational, institutional, and retail construction.

*Erik Williams is an Associate in Saul Ewing’s Real Estate Department and is based in the Firm’s Philadelphia office. He focuses his practice in the area of commercial real estate transactions, with an emphasis in site acquisition, finance, construction, and leasing matters. Erik can be reached at 215.972.7542, or at ewilliams@saul.com.*