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Waiver of subrogation provisions are often misunderstood or overlooked, but these provisions are important to both landlords and tenants, because they serve an important risk-allocation function. Failure to consider the scope of the provision could result in unintended risk exposure for one or both parties.

Subrogation is a major component of commercial insurance policies. Subrogation allows the insurance company, after paying its insured for a loss covered under the policy, to pursue any right of action the insured might have had against a third party whose negligence or wrongful act caused the loss that was insured under the policy. This concept allows the insurance company to "step into the shoes" of the insured to seek recovery for the amount that it was required to pay out to its insured as a result of the claim.

By way of example, if a tenant negligently causes an incident which destroys all or part of the landlord's building, the landlord likely carries insurance for this type of loss and would make a claim with its insurer for the cost to repair or replace the damage. Under the policy, the insurer would pay its insured, the landlord, for the loss. If the lease contains no provision waiving the right to subrogation for this type of loss, the insurer would then be able to make a claim against the tenant to recover the amount it was required to pay as a result of the claim. This may not be the result the landlord and tenant intended when they negotiated the scope of insurance coverage each was required to carry.

A waiver of subrogation provision allows the parties to allocate the risk of loss related to their lease agreement to their respective insurance carriers. This concept is based on the premise that the parties are free to allocate risk amongst each other at the formation of the contract, including by agreeing to procure insurance for specific types of potential losses or liabilities. Typically, a waiver of subrogation provision operates to waive any right of recovery against the other party to the lease to the extent the loss is covered by a party's insurance.

When negotiating and reviewing waiver of subrogation provisions in a commercial lease, landlords and tenants should address several considerations, including the following:

1. Will the waiver of subrogation be mutual or will it only benefit one party?
2. To which insurance policies will the waiver of subrogation clause apply? Note that the most common application is to the parties' respective property insurance policies, but, though less common, waiver of subrogation provisions may also be applied to other types of policies required by the lease. Landlords and tenants should confirm that their respective insurance policies permit such waivers of subrogation.
3. Are there limits on the scope of the waiver? For example, will the waiver be limited only to the extent insurance proceeds are actually received as a result of the loss? Or perhaps the waiver will be limited to those risks that are specifically required to be insured under the lease regardless of whether or not the party has actually insured those risks.
4. For those insurance policies required under the lease to which the waiver of subrogation provisions will not apply, consider whether the interests of the other party may be protected in another way, for example, by naming the other party as an additional insured.
5. It is important that the waiver of subrogation provisions in a lease be reviewed in light of the other insurance, indemnification, and related provisions to ensure consistency, continuity, and an adequate reflection of the allocation of risk the parties have agreed to.

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