EXPERT COMMENTARY

SUBROGATION AND THE CGL POLICY

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We demand it of others because it is demanded of us. Although it seems everyone wants it, how it works and what it does are often vague or misunderstood entirely.

Nonetheless, a waiver of subrogation endorsement is commonly *required* to be attached to a commercial general liability (CGL) policy.

What Is Subrogation?

According to *Black's Law Dictionary,* 8th ed., subrogation is "The principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to the loss covered by the policy." Subrogation generally refers to both a legal right and a legal action.[1] In other words, subrogation can mean either the insurer's right to recover or the actual process of recovery by the insurer.

[1]Rowland H. Long, The Law of Liability Insurance (1998), at 23–2.

What Is the Purpose of Subrogation?

The goal of subrogation is to ultimately hold the wrongdoer responsible for the damage caused to the insured.[2] Subrogation also eliminates the possibility that the insured might obtain a duplicate recovery[3]—once from its insurer, another from the tortfeasor. While recovering twice for the same claim seems repugnant and unlikely, it is quite plausible due to the collateral-source rule.[4]

Subrogation in the CGL

The CGL policy (Insurance Services Office, Inc. (ISO), commercial general liability coverage

[2]State, Dep't of Human Servs. ex. rel. *Palmer v. Unisys Corp.,* 637 N.W.2d 142 (Iowa 2001).

[3]Rowland at 23–5 (2004).

[4]Collateral-source rule: The doctrine that if an injured party receives compensation for the injuries from a source independent of the tortfeasor, the payment should not be deducted from the damages that the tortfeasor must pay. Insurance proceeds are the most common collateral source. *Black's Law Dictionary,* 8th ed.

form, April 2013 edition) does not actually use the term "subrogation."

Rather, a condition of the CGL policy titled "Transfer of Rights of Recovery Against Others to Us" contains the operative wording. The descriptive wording of the title captures much of the essence of subrogation—if an insured has a right to recover from another, that right of recovery is transferred to the insurer.

Of course, the title does not express the terms of the provision in its entirety. As a condition of coverage, the insured not only agrees to transfer its rights of recovery to the insurer for loss paid under the CGL policy; the insured also agrees to help the insurer enforce the insured's rights against the liable third party (tortfeasor) and further to do nothing after loss to impair the insurer's rights of recovery.

Illustration of Subrogation in the CGL Policy

While subrogation arises more frequently with first-party property insurance, here is an illustration of how subrogation may work in a CGL policy.

> Clean Cut Corp. manufactures table saws. Some of the components are made by others—such as the electrical motor that drives the saw blade. One of Clean Cut's table saws unexpectedly catches fire, severely damaging a commercial building and injuring its user. Clear cut is found liable to the plaintiff for tort damages of $500,000. However, in the course of the investigation, it seems clear to Clean Cut and its CGL insurer that the fire was caused by a defective motor supplied to Clean Cut and used as a component part of the table saw. Clean Cut's CGL insurer pays damages to the plaintiffs of $500,000 but takes Clean Cut's rights to recover from the electric motor manufacturer in a subrogation action. The litigation against the electric motor manufacturer is successful—Clean Cut's insurer recovers the $500,000 it has paid on Clean Cut's behalf as tort damages to the plaintiff.

In the above illustration, the insurer has taken the insured's right to recover from the electric motor manufacturer and has pursued that right successfully, resulting in the insurer recovering from the wrongdoer (the electric motor manufacturer) the damages it paid on behalf of its insured.

Now let's change the facts a bit.

Illustration of Subrogation in the CGL Policy—Effect of Release of Liability

We will actually change only one fact—when Clean Cut's insurer tried the case, the electric motor manufacturer's defense was predicated on one document—a purchase order (PO) between Clean Cut and the electric motor manufacturer. The PO stated, "The parties agree that the supplier (electric motor manufacturer) is not liable to the purchaser (Clean Cut) for any liability arising out of the product (electric motor)...." If the court upholds as enforceable the release wording (an exculpatory agreement), what will be the result?

Has Clean Cut Breached a Policy Condition?

Clean Cut is required only to "do nothing after loss" to impair the recovery rights of the insurer. As the PO was executed prior to the loss, Clean Cut has not breached a policy condition. It is generally understood that releasing another from liability *prior to a loss* is allowed by the CGL and does not violate the "Transfer of Rights of Recovery Against Others" provision.

Will Clean Cut's Insurer Recover What It Has Paid on Behalf of Clean Cut?

Here is where a clearer understanding of the principles of subrogation is tested. While many

believe that the right to recover from the electric motor manufacturer is an *independent* right of Clean Cut's insurer and that the PO cannot affect the insurer's right (after all, the insurer did not agree to waive subrogation), such a conclusion is mistaken.

When an insurer asserts a subrogation claim against a third-party tortfeasor, the insurer's rights are limited to the rights of recovery possessed by the insured. That is because the rights acquired by the insurer against a wrongdoer rise "no higher" than those of the insured against the wrongdoer.[5] The corollary is that the insurer's subrogation claim is also subject to all defenses that can be asserted against the insured.[6] In our illustration, the PO *has the effect* of extinguishing the insurer's right to recover from the electric motor manufacturer in the subrogation action, despite the fact that the insurer never agreed to waive or otherwise give up its right of recovery as Clean Cut's insurer.

A Costly Misunderstanding

Going back to our illustration, let's change the facts one more time. Instead of using an exculpatory agreement in its PO with Clean Cut, the electric motor manufacturer demands only that Clean Cut's CGL policy be endorsed to include the ubiquitous waiver of subrogation endorsement.

Of course, the actual endorsement is titled "Waiver of Transfer of Rights of Recovery Against Others to Us" with an ISO form number of CG 24 04 05 09. Regardless, Clean Cut's insurer agrees to add the CG 24 04 and lists the electric motor manufacturer in the schedule prior to the fire and subsequent loss.

If all of the other facts remain the same, it is evident that Clean Cut's insurer has agreed to waive any rights of recovery against "the person or organization shown in the Schedule." What is important here is that only Clean Cut's *insurer* has waived its rights to recover—Clean Cut has not waived any rights. Clean Cut may, for any number of reasons (one might be that Clean Cut has a large deductible or self-insured retention on its CGL policy), seek recovery from the electric motor manufacturer directly—an eventuality that the electric motor manufacturer wrongly thought was foreclosed by requiring the "Waiver of Transfer of Rights of Recovery Against Others to Us" endorsement. This may indeed be a costly mistake by the electric motor manufacturer resulting from a misunderstanding of the principle of subrogation and further failing to realize the limitations of the "Waiver of Transfer of Rights of Recovery Against Others to Us" (CG 24 04) endorsement.

The Antisubrogation Rule

Again according to *Black's Law Dictionary,* this rule stands for "the principle that an insurer has no right of subrogation—that is, no right to assert a claim on behalf of the insured or for payments made under the policy—against its own insured for the risk covered by the policy."

No right of subrogation can arise in favor of the insurer against its own insured, since, by definition, subrogation arises only with respect to the rights of an insured against third persons to whom the insurer owes no duty.[7]

Despite the fact that some in the insurance industry and risk management field occasionally deny the existence of the antisubrogation rule, it is well settled, described in some instances as "black letter law." "An insurer has no right of subrogation against its own insured for a claim arising from the very risk for which the insured was covered."[8] In fact, this makes perfect sense—it would defeat the purpose of in-

[5] *Employers Mut. Cas. Co. v. Hanshaw,* 176 N.W.2d 253 (Iowa 1970).
[6] *Connor v. Thompson Constr. & Dev. Co.,* 166 N.W.2d 109 (Iowa 1969).
[7] Couch on Insurance 2d (1983), S61:136.
[8] *Motors Ins. Corp. v. Africk,* 55 A.D.3d 571 (N.Y. App. Div. 2008).

surance if an insurer paid on behalf of its insured and was then allowed to recover from its insured the amount it just paid. Insurance would truly revert to a bond in this instance. However, the antisubrogation rule is not unlimited—there are situations in which it would *not apply* to an insured.

Additional Insureds and Waiver of Subrogation

Waiver of subrogation endorsements and additional insured status on the *same CGL policy* are ordinary requirements in the construction industry. But if the antisubrogation rule prevents subrogation against an insured, is this requirement not redundant? In other words, if a general contractor was afforded additional insured status on the CGL policy of a subcontractor, is the waiver of subrogation endorsement really necessary? While there is usually substantial overlap, there are a few situations in which it may be necessary to prevent subrogation by the subcontractor's insurer.

Illustration—General Contractor and Subcontractor

In a construction project to build a department store, the general contractor has required the iron and steel subcontractor to add the general contractor as an additional insured on the subcontractor's CGL policy. The subcontractor complies—its CGL policy includes the general contractor as an additional insured via CG 20 10 04 13. Two months *after* the project is finished, a support beam erected by the subcontractor falls and injures a patron of the completed store. The patron sues only the iron and steel subcontractor—which is found liable for damages. It becomes apparent during the investigation that, while the iron and steel contractor may have some fault, the general contractor directed the iron and steel subcontractor in how to weld the beams.

It was the welding technique demanded by the general contractor that was, in large part, the reason the beam fell. After paying damages on behalf of the iron and steel subcontractor, the subcontractor's insurer brings a claim against the general contractor, via subrogation, to recover some of the damages paid to the injured patron.

Antisubrogation Defense

The general contractor's defense is that the antisubrogation rule applies—it was an additional insured on the CGL policy issued by the insurer at the time of the loss, and thus, the insurer is barred from seeking any recovery.

The flaw in the general contractor's defense is that the antisubrogation rule only *applies to the extent the insurer has a duty to that insured.* This is not a risk for which the general contractor has been provided coverage.[9] The reason is that the coverage afforded to the general contractor as an additional insured is for ongoing operations only—CG 20 10 04 13 expressly excludes coverage for the additional insured/general contractor for any bodily injury or property damage arising out of the products-completed operations hazard. The claim being pursued is a *completed operations claim*—for which the general contractor is not an insured under CG 20 10. Thus, the insurer would not be prohibited by the antisubrogation rule from seeking recovery from the general contractor.

The requirement to include the "Waiver of Transfer of Rights of Recovery Against Others to Us" (CG 24 04) endorsement as well as additional insured status is to prevent the "no coverage exception" to the antisubrogation rule found in the above illustration.

[9] *Rosato v. Karl Koch Erecting Co.,* 865 F. Supp. 104 (E.D.N.Y. 1994). Antisubrogation rule was not a bar to insurer's indemnification action against its own insured because the insurance policy between them was inapplicable to the loss at issue.

Conclusion

The effective transfer of risk requires a basic understanding of the principles of subrogation, including the antisubrogation rule, as well as the purpose and limitations of the Waiver of Transfer of Rights of Recovery Against Others to Us endorsement (CG 24 04 05 09) that is so routinely demanded but so often misunderstood. For example, use of the CG 24 04 endorsement does not result in "primary and noncontributory" coverage for the additional insured. To learn more on the differences between contribution among insurers and the doctrine of subrogation, see also "Primary and Noncontributory" (March 2013).

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