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The Importance Of Attention To Risk Allocation Provisions In Contracts

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A recent Indiana Court of Appeals decision illustrates the importance of having an overall risk allocation strategy in contracts where appropriate, and paying close attention to the language used to express that strategy, particularly when multiple contracts and parties are involved. Contractual risk allocation provisions previously have been a focus of this blog and webinars offered by our Insurance Recovery and Counseling Group.

In *Performance Services, Inc. v. Hanover Ins. Co.*, 85 N.E.3d 655 (Ind. Ct. App. 2017), a school district submitted a property insurance claim to its insurer, Hanover, for damage that occurred during a construction project at a high school. Hanover paid nearly $700,000 to settle the claim. Hanover later asserted a subrogation claim against two contractors who had worked on the project, PSI and Huntingburg, to recover the amount it paid to settle the claim. Hanover's ability to recover depended on the analysis of risk allocation provisions in three different contracts:

1. The first contract was between the school district and a construction manager who oversaw the project. That contract had standard form American Institute of Architects (AIA) language, including a waiver of subrogation clause. The waiver of subrogation clause also stated that the school district would require similar waivers from other contractors working on the project.

2. The second contract was one between the school district and PSI for construction work PSI performed. That contract did not include an express waiver of subrogation provision.

3. A third contract between PSI and Huntingburg, who acted as a subcontractor, did contain an express waiver of subrogation clause.

Hanover argued that the second contract– which lacked its own express waiver of subrogation clause – controlled the viability of its subrogation claim. The court disagreed, ultimately concluding that the waiver of subrogation provision in the AIA-form contract with the construction manager evidenced an intent for all parties involved with the project to waive subrogation against contractors and subcontractors. The court further concluded the "total effect of all the contracts was to distribute the risks incidental to the Project to an insurance carrier." 85 N.E.3d at 664.

This case illustrates the difficulty of coordinating risk allocation language across multiple contracts. Hanover might have attempted to pursue subrogation claims under any circumstances, but it seems possible that litigation might have been avoided if all of the contracts at issue had contained their own express waiver of subrogation clauses. By the same token, there often are times when contracting parties do not want to place the risk of losses solely on insurance. For instance, a party who is entitled to indemnification from the other contracting party and who requires that

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insurance be maintained and available for indemnity claims may not want to limit itself to recovering solely from the insurance in the event of a loss. If so, it can be important to spell out that intention expressly depending on what jurisdiction's law governs. Whatever the ultimate intent of the parties, it is important to pay attention at the outset of a transaction to contractual risk allocation provisions so that the parties' intentions about who should bear the risk of losses can be enforced.