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NEWSLETTERS

Indiana Courts Wrestle With "Work" V. "No-Work" Distinction In Waiver Of Subrogation Cases

April 1, 2014 | Atlanta | Chicago | Columbus | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

When confronted with the argument that a party has waived its claims under an AIA standard waiver of subrogation provision, Indiana has traditionally applied a "Work" vs. "No-Work" distinction when evaluating whether a project owner has waived its claims. Despite prior case law applying this distinction, on Feb. 14, 2014, the Indiana Court of Appeals, in *Bd. of Comm'rs of the Cnty. of Jefferson v. Teton Corp.*, 3 N.E.3d 556 (Ind. Ct. App. 2014), held that a work vs. no-work distinction should not apply. Because the project owner failed to secure the insurance required under the contract, failed to give notice to the general contractor of the decision not to secure the insurance, and waived its subrogation claims, the court held the owner breached the contract and had waived all subrogation claims against its contractor and subcontractors.

Jefferson County, Indiana, decided to repair and renovate its courthouse and hired Teton Corporation as its general contractor. The parties executed an AIA contract which contained the following provisions:

Unless otherwise provided, the Owner [Jefferson County] shall purchase and maintain . . . property insurance in the amount of the initial Contract Sum as well as subsequent modifications thereto for the entire Work at the site on a replacement cost basis without voluntary deductibles… This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Work.

Property insurance shall be on an "all-risk" policy form and shall insure against the perils of fire and extended coverage and physical loss or damage including, without duplication of coverage, theft, vandalism, malicious mischief, collapse, falsework, temporary buildings and debris removal including demolition occasioned by enforcement of any applicable legal requirements, and shall cover reasonable compensation for Architect's services and expenses required as a result of such insured loss. Coverage for other perils shall not be required unless otherwise provided in the Contract Documents.

If the Owner does not intend to purchase such property insurance required by the Contract and with all of the coverages in the amount described above, the Owner shall so inform the Contractor in writing prior to commencement of the Work. The Contractor may then effect insurance which will protect the interests of the Contractor, Subcontractors and Sub-subcontractors in the Work, and by appropriate Change Order the cost thereof shall be charged to the Owner. If the Contractor is damaged by the failure or neglect of the Owner to purchase or maintain insurance as described above, without so notifying the Contractor, then the Owner shall bear all reasonable costs properly attributable thereto.

Loss of Use Insurance. The Owner, at the Owner's option, may purchase

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and maintain such insurance as will Insure the Owner against loss of use of the Owner's property due to fire or other hazards, however caused. The Owner waives all rights of action against the Contractor for loss of use of the Owner's property, including consequential losses due to fire or other hazards however caused.

If during the Project construction period the Owner insures properties, real or personal or both, adjoining or adjacent to the site by property insurance under policies separate from those insuring the Project, or if after final payment property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period, the Owner shall waive all rights in accordance with the terms of Subparagraph 11.3.7 for damages caused by fire or other perils covered by this separate property insurance. All separate policies shall provide this waiver of subrogation by endorsement or otherwise.

Waivers of Subrogation. The Owner and Contractor waive all rights against [] each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other . . . for damages caused by fire or other perils to the extent covered by property insurance obtained pursuant to this Paragraph 11.3 or other property insurance applicable to the Work, except such rights as they have to the proceeds of such insurance held by the Owner as fiduciary. . . .

Jefferson County did not obtain separate property insurance for the courthouse project, instead relying on its existing property and casualty insurance policy. The county did not inform Teton that it was not securing separate insurance for the project. During the renovation, a fire broke out, causing over $6 million in damages. After the county’s insurance company paid under the terms of its policy, the county sued Teton, a subcontractor, and a sub-subcontractor for the damages. The defendants all claimed that Jefferson County waived its claims under the subrogation waiver provision of the contract between the county and Teton. The county claimed that under Indiana law, it did not waive its claims because this case involved damage to no-work property.

Prior to this lawsuit, Indiana evaluated these types of cases by applying a work vs. no-work distinction to the damage claims. For example, in two earlier cases the Indiana Court of Appeals analyzed claims that the project owners had waived their claims under similar subrogation waiver provisions. In one case, the court held that the waiver of subrogation was limited to the work performed under the contract. Therefore, to the extent the project owner suffered damage to contents placed in the building, those damage claims were not within the scope of “work” and had not been waived. Similarly, in a different case the court also drew a distinction between damage to the Work and damage to non-work property when finding that the general contractor and subcontractors could be liable for soil cleanup costs to the property surrounding the jobsite or the property outside the building project itself.

When evaluating the county’s arguments, the court analyzed the prior Indiana decisions and concluded that Indiana’s application of the Work vs. non-Work distinction was the minority view. The court then analyzed cases from other jurisdictions which did not apply the distinction. Ultimately, the court decided that contrary to Indiana’s past application of the distinction, that the majority view was a better approach and that the

court should not apply a work vs. non-work analysis. In so holding, the court stated that the no-work distinction would throw many construction projects into protracted litigation and that by applying the waiver "to all losses covered by the owner's property insurance, the parties avoid the predictable litigation over liability issues and whether the claimed loss was damage to work or non-work property."

Equally as important, the court noted that the contract required Jefferson County to "purchase and maintain" "property insurance on an all-risk form" and that the county failed to do so. In a footnote, the majority disagreed with the dissent that a blanket property and casualty insurance policy meets the definition of an all risk policy. The court also found that the county breached the contract by failing to notify Teton that it did not purchase the separate policy. The court concluded by holding that the AIA contract required Jefferson County to separately insure its interests in the project and in order to facilitate the completion of the project without delaying and debilitating litigation, to obtain an 'all-risk' insurance policy that waives the carrier's rights to be subrogated to any loss arising within the extremely broad coverage described in the contract. If the owner does not secure such insurance, then it still waives its rights for any loss described within the AIA contract.

On March 5, 2014, a petition for rehearing was filed in this case. As it currently stands, project owners need to be familiar with this case as it may signal a change in Indiana's view on the scope of the subrogation waiver provisions in construction contracts. Specifically, project owners need to be aware that if they chose not to purchase separate coverage even though it may be required under the contract, they may still be subject to the waiver of subrogation provisions. Finally, as this was a Court of Appeals decision, the prior decisions invoking the work vs. no-work distinction have not been overruled, creating some uncertainty as to the future of these types of claims.

For more information about this topic and the issues raised in this article, please contact Alice J. Springer in our South Bend office at (574) 237-1120 or by email at alice.springer@btlaw.com.

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