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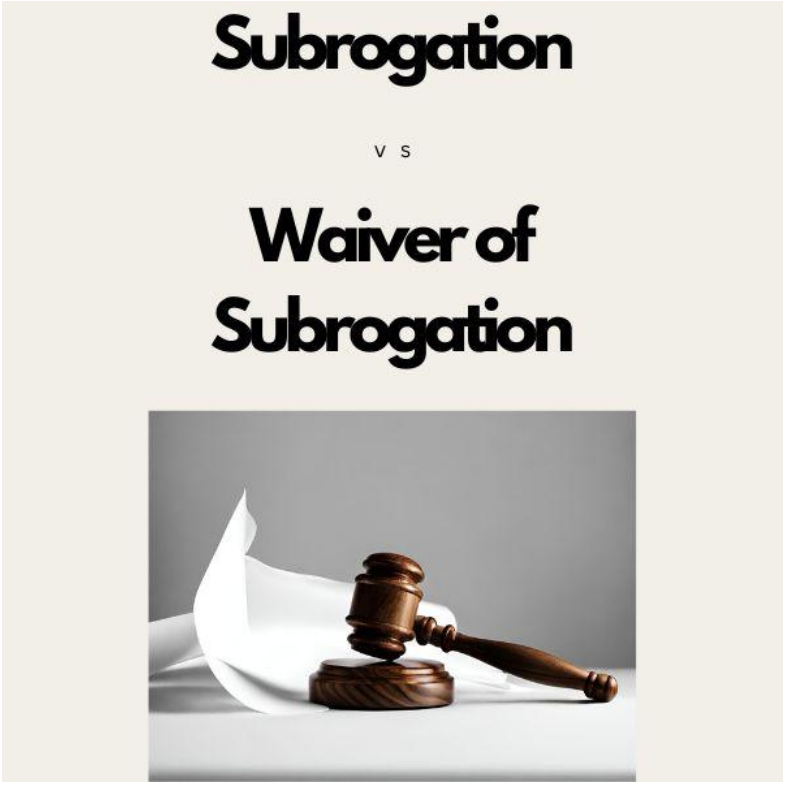

What Does Subrogation and Waiver of Subrogation Mean and Why Does It Matter in Commercial Leases?

The terms “Subrogation” and “Waiver of Subrogation” are often found in many types of contracts. While these terms may not be familiar to non-lawyers, they are very important in allocating risk among parties to a transaction – especially in commercial leases. Landlords and tenants should understand what these terms mean and the importance of how they are used when negotiating leases to avoid unintended risk exposure.

Subrogation
"Subrogation" refers to the act of person or party standing in the place of another person or party. It is a legal right held by an insurance carrier that has paid a loss under an insurance policy to stand in the shoes of its insured to recover that loss from a third party. For example, a subrogation provision in a lease may allow a tenant's insurer that has paid a loss wrongfully caused by the landlord, to step into the shoes of the tenant and make a claim against the landlord. In this example, the right of subrogation is beneficial to the tenant because if its insurer can recover the loss from landlord, that recovery can mitigate against the tenant incurring an increase in its insurance premiums due to the loss.

Waiver of Subrogation
The term "waiver of subrogation" means that one party waives its rights to recover a loss from the other party – often to the extent the loss is covered by the waiving party's insurance. In the above scenario, if a waiver of subrogation was included, the tenant's insurer would not be allowed to "step into the shoes" of the tenant and assert a claim against the landlord. That is because the tenant would have waived its right to have its insurer recover the loss from the landlord. The waiver of subrogation would not only protect the landlord from the costs of potential litigation, but would also make it clear which party (and which party's insurer) is responsible for damage suffered during the lease.

A waiver of subrogation provision allows the parties to allocate the risk of loss related to their lease agreement to their respective insurance carriers. A waiver of subrogation can be desirable because (1) a waiver can avoid disputes between landlord and tenant and encourage prompt repairs in lieu of possible, ongoing costly litigation and (2) it is economically efficient as only one party needs to value and insure the risk.

In negotiating subrogation and waiver of subrogation provisions in commercial leases, the parties should consider the following:

1. Will the waiver of subrogation apply to both landlord or tenant, or just to one party?
2. Does a party's insurance policies (especially property insurance) allow for a waiver of subrogation? A party should verify with its insurer that waiver of subrogation is permitted before agreeing to such a waiver in a lease.
3. Will the waiver of subrogation apply only to insured risks or to all risks?
4. Will waiver of subrogation apply in cases of willful misconduct or gross negligence?

The concepts of subrogation and waiver of subrogation are very important in the context of commercial leasing. If the parties agree to a waiver of subrogation, the waiver provision must be carefully crafted and accompanied by appropriate contractual requirements that the parties procure insurance consistent with the waiver requirements. Parties also must be careful to ensure that their intent to waive subrogation rights is not abrogated by virtue of other inconsistent provisions of the lease.

**This client alert is for informational purposes and is not legal advice. View previous issues of Monday Minute.*

If you have any questions or legal needs, please reach out to:

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