MARYLAND HIGH COURT INTERPRETS AIA WAIVER OF SUBROGATION

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The Maryland Court of Appeals, the highest court in Maryland, recently provided additional color to an often litigated construction contract dispute—the scope and applicability of the waiver of subrogation provision in the American Institute of Architects (AIA) A107-1997 construction contract.1 The primary issue addressed by the Court was whether the waiver of subrogation clause applied to a claim for damages occurring after substantial completion and final payment for a construction project. The Court determined that the A107-1997 contract was ambiguous and remanded the case to the trial court to determine the intent of the parties. This Subrogation Alert! focuses on this decision and its implications for prosecution of similarly situated subrogation claims.

In Mattingly, the Owner contracted with a contractor to construct an Arby’s Restaurant using a standard form AIA A107-1997 construction contract. Four sections of that contract were particularly relevant in the Court’s opinion: Section 16.4 dealt with insurance required for the project; Section 16.5 included the waiver of subrogation; Section 6.3 defined “the Work,” i.e. the construction project at issue; and Section 14.5.3 essentially provided a warranty after final payment. The provisions, in pertinent part, stated:

16.4.1: …[t]he Owner shall purchase and maintain,… property insurance on an “all risk” policy form, including builder’s risk,… Such property insurance shall be maintained,… until final payment has been made… or until no person or entity other than the Owner has an insurable interest in the property, whichever is later.

16.5.1: The Owner and Contractor waive all rights against… each other and any of their subcontractors… for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to paragraph 16.4 or other property insurance applicable to the Work…

6.3: The term “Work” means the construction and services required by the Contract Documents, whether completed or partially completed, and includes all other labor, materials, equipment and services provided or to be provided by the Contractor to fulfill the Contractor’s obligations. The Work may constitute the whole or a part of the project.

14.5.3 The making of final payment shall constitute a waiver of claims by the owner except those arising from:… 2 failure of the Work to comply with the requirements of the Contract Documents.

The Arby’s restaurant opened for business in October, 2003 and final payment under the contract was made at that time. In May of 2005, a fire occurred due to a failure of electrical wiring. The damages were in excess of $1 million.

At the time of the fire, the owner had an insurance policy with the Hartford, effective October 1, 2004—October 1, 2005. Once Hartford paid the claim, it pursued subrogation against the contractor and a subcontractor. Defendants raised the waiver of subrogation clause as a defense, leading to summary judgment in favor of defendants. On appeal, the court reversed summary judgment because the definition of “the Work” was ambiguous as to whether it encompassed losses sustained after substantial completion of construction and final payment. The Maryland Court of Appeals agreed and remanded the case for further discovery as to the intent of the parties.

The Court cited several sources of ambiguity within the contract. For example, on the one hand, the contract preserved the owner’s claims for defects arising after final

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payment. On the other hand, however, the contract required the owner to waive its insurer’s subrogation rights to the extent of the damages covered by property insurance maintained on the Work, which was defined in the contract as the completed or partially complete project.

The contract provided the owner with a warranty that would be nullified by extending the waiver of subrogation to post-construction claims. Thus, the trial court’s grant of summary judgment eliminated the owner’s right to pursue the defendant contractor for defect claims, a right which was clearly provided for in the contract. The ambiguity became apparent when the court tried to square an unholy trinity of conflicting contract provisions: comparing (1) what constitutes “the Work” against, (2) whether the owner’s policy with Hartford qualified as “other property insurance applicable to the Work,” and (3) whether the owner’s policy acts to nullify the warranty given to the Owner.

Defendants unsuccessfully relied on the Silverton line of cases which, interpreting other AIA contracts, held that a waiver of subrogation was enforceable after completion of the work and final payment. However, the contracts involved in those cases differed from the contract here because they contained waiver of subrogation clauses that expressly extended the waiver of subrogation provision to post construction losses:

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 [the waivers of subrogation clause] for damages caused by fire or other perils covered by this separate property insurance.

The contracts in the Silverton line of cases clarified the intent of AIA (and parties utilizing their contracts) to waive subrogation after substantial completion. However, the contract in Mattingly did not include an express post-construction waiver, leading to the Court’s holding that the contract was sufficiently ambiguous enough to warrant reversal and remand to the trial court for additional discovery as to the intent of the parties.

For the subrogation professional, this case further emphasizes the prudence of taking a closer look at an AIA contract. A waiver of subrogation under these documents is not necessarily a bar to otherwise viable subrogation claims. If the intent to waive subrogation is not clearly and unambiguously expressed in the contract, a subrogation claim which at first blush may not have appeared to be viable may have life after all.

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