

Federal Courts Refuse to Enforce Waiver of Subrogation Clauses in Certain Residential Situations

In two recent decisions, federal courts sitting in New Jersey and Pennsylvania refused to dismiss subrogation claims filed by the insurers of a homeowner and lessees of apartments who suffered damages paid by their carriers. The waiver of subrogation clauses were located in an oil delivery service contract and apartment leases.

In October 2016, Judge Schmehl of the U.S. District Court for the Eastern District of Pennsylvania considered a waiver of subrogation clause in a service contract for oil delivery. *State Farm Fire & Casualty Co. a/s/o Sarah Rivera v. Petroleum Heat & Power Co.*, 2016 WL 5816182 (E.D. Pa. October 5, 2016). Judge Schmehl determined that the clause at issue violated public policy because it permits the party who is in the best position to prevent the risk of, and consequences resulting from, a residential oil spill to simply transfer the risk to the resident's insurance company, thereby unilaterally absolving itself as a tortfeasor from any liability in causing the spill. The court acknowledged that Pennsylvania courts had repeatedly enforced waiver of subrogation clauses in AIA construction contracts. Judge Schmehl determined that the policy considerations that applied to commercial construction contracts are simply not applicable to a consumer contract similar to the one at issue.

The court also found that the contract was a contract of adhesion. As a result, the court stated that even if the waiver of subrogation clause was not an exculpatory clause under Pennsylvania law, the court found that it was unconscionable and void. In particular, the insured lacked a meaningful choice in the acceptance of the provision and it was not in actuality mutual as only the oil company benefited.

In *Allstate New Jersey Insurance Company v. Avalon Bay Communities, Inc.*, Senior District Judge Walls addressed waiver of subrogation clauses contained in residential apartment leases. The court labeled the opinion as "not for publication," which limits its precedential value but the reasoning is still sound. Allstate insured a number of tenants that suffered damages as a result of a fire in January 2015 and sought recovery against the landlord for negligently starting a fire while its employees were performing maintenance work.

Senior Judge Walls recognized that in New Jersey courts would ordinarily enforce subrogation waivers based on the rationale that the court should not interfere when parties waive their rights to subrogation because they intended to shift the risk of loss to insurance policies. However, in this case, the court pointed out that all 24 residential leases at issue consisted of a standardized printed form, presented without opportunity for negotiation on a vast majority of the provisions, including the subrogation waiver. Similar to Judge Schmehl, Senior Judge Walls determined that the insureds lacked a meaningful choice in the acceptance of the subrogation waiver and analyzed New Jersey substantive law regarding the four factors that courts consider in determining whether an adhesion contract is unconscionable. The court noted that the waiver was located in Paragraph 32 of the lease agreement and that the bargaining positions of landlords and tenants in apartment buildings are decidedly unequal. In addition, the subrogation provision was completely one sided.

Senior Judge Walls also determined that public interests affected by the contract also militated toward finding the waiver of subrogation unenforceable. The policy considerations with respect to commercial contracts were not present, and the enforcement of the waiver could lead to a decreased standard of care by landlords and increased insurance costs for tenants. Insurers could also simply include contract provisions violating any policies when tenants waived their rights of subrogation or could stop issuing comprehensive property and liability renter's insurance policies to tenants who waived subrogation. Finally, the court pointed out that the procedural context of where the clause was located, being virtually hidden, further emphasized that the insureds were not



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engaged in a business decision to allocate the risk of loss to the tenant's insurer.

Avoiding waivers of subrogation in contracts and leases can be challenging. Nevertheless, two recent federal court decisions in neighboring states provide ammunition that waivers of subrogation in homeowners' service contracts and residential lease agreements can be successfully challenged.

For additional information on this developing area of the law, please feel free to contact Mark Mullen at (215) 665-20910 or mmullen@cozen.com or Sean O'Donnell at (215) 665-2089 or sodonnell@cozen.com.