

Waiver of Subrogation and Lack of Contractual Privity Bars Commercial Tenants' Claims

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In *United States Automatic Sprinkler Corporation v. Erie Insurance Exchange, et al.*, No. 2SS-CT-264, 2023 Ind. LEXIS 105, the Supreme Court of Indiana (Supreme Court) reversed an order of the trial court that denied a motion for summary judgment filed by a sprinkler contractor. At issue was whether commercial tenants – one who contracted with the sprinkler contractor and others who did not – could recover for their respective property damages. The court held that under the contract's subrogation waiver and agreement to insure, the contracting tenant waived its insurer's rights to recover through subrogation. With respect to the non-contracting tenants, who sought to recover only property damages, the court held that the absence of contractual privity barred their recovery.

The case centered around a sprinkler system that malfunctioned and flooded the Sycamore Springs Office Complex (Landlord), causing extensive property damage to four commercial tenants. Surgery Center, one of the four tenants, requested permission from the Landlord to install a sprinkler system inside the building. Landlord agreed, in exchange for Surgery Center agreeing to be solely responsible for maintaining the sprinkler system. Surgery Center hired United States Automatic Sprinkler (Automatic Sprinkler) to both install and conduct periodic inspection and testing of the sprinkler system. The contract terms outlined the scope of work to be performed by Automatic Sprinkler and the work was limited to the inspection and testing of the sprinkler system. Although repairs and emergency services were excluded from the contract, each could be performed upon the request and authorization of Surgery Center for an additional cost. The contract also contained certain risk allocation provisions including a waiver of subrogation and an agreement to insure.

In December 2016, Landlord's maintenance employee discovered a leak in the sprinkler system. He notified Automatic Sprinkler of the issue. An employee of Automatic Sprinkler identified the source of the leak and made some adjustments to the system. A few days later, water in the sprinkler system froze and ruptured the pipes, causing damage to each tenancy. Following the loss, Surgery Center filed a claim with its property insurer. The insurer honored the claim and filed a lawsuit as subrogee of Surgery Center against Automatic Sprinkler, seeking recovery of its losses. The remaining three tenants ("Non-Contract Tenants") also filed lawsuits against Automatic Sprinkler. The actions were consolidated, and Automatic Sprinkler moved for summary judgment against Surgery Center and the Non-Contract Tenants.

With respect to the subrogation action filed by Surgery Center's insurer, Automatic Sprinkler argued it was entitled to summary judgment because the contract included an agreement to insure and a waiver of subrogation. With respect to the Non-Contract Tenants, Automatic Sprinkler argued that it was entitled to summary judgment because it did not owe a duty to the Non-Contract Tenants and therefore could not be liable for their property damage. The trial court denied both motions. The Supreme Court reversed the order of the trial court.

First, the court addressed the viability of the subrogation action filed by Surgery Center's insurer. Surgery Center contended that the waiver of subrogation provision applied only to losses sustained through work completed within the scope of the agreement. The Supreme Court found that "the inspection agreement's unambiguously broad subrogation waiver and agreement to insure evince[d] the parties' intent to shift all risk of loss — irrespective of its source — to insurance." The agreement to insure provided that Surgery Center would "be responsible for maintaining all liability and property insurance." The subrogation waiver stated, "no insurer or third party will have any subrogation rights against [Automatic Sprinkler]." The court reasoned that both provisions, as written, were "not

conditioned on Surgery Center's loss arising in any particular way."

Next, the court considered whether Automatic Sprinkler was entitled to summary judgment against the Non-Contract Tenants. The Non-Contract Tenants argued that Automatic Sprinkler had a duty to prevent damage to their property. In reviewing their negligence claim, the court turned to its common law to determine when a contractor can be liable to third parties for property damage.

The court noted that, like in *Citizen Gas & Coke Utility v. American Economy Insurance Co.*, 486 N.E.2d 998 (Ind. 1985), it traditionally follows the acceptance rule, which generally protects contractors from third party liability when the work is completed and accepted by the owner. Although the court acknowledged the foreseeability doctrine – which can serve as an exception to the privity requirement for third party property damage claims – the court noted that Automatic Sprinkler's alleged negligence did not pose a risk of injury to the Non-Contract Tenants. Thus, the court found its decision in *Citizen Gas* controlling and held that the lack of privity bars the Non-Contract Tenants negligence claims against Automatic Sprinkler. The court – quoting *Eaves Brooks Costume Co. v. Y.B.H. Realty Corp.*, 76 N.Y.2d 222 (1990) – wrote that imposing third party-liability on companies like Automatic Sprinkler would force them to "insure against a risk the amount of which they may not know and cannot control."

This case illustrates the importance of gathering the relevant facts early in the subrogation investigation. For property damage claims caused by negligent contractors, this includes identifying the contractual relationship between the parties, reviewing the applicable contracts for subrogation waivers and agreements to insure, determining whether the cause of the damage arose from the scope of work outlined in the contract and discerning who requested the work the contractor performed. Using this information, subrogation professionals can then determine if a waiver of subrogation or lack of contractual privity pose challenges to an insurer's recovery.

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