Getting Something Back:

Subrogating After the Catastrophe

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The right to redress that is fundamental to our justice system does not stop at the insurance company's door. The law of subrogation, whether conventional or equitable, has evolved into the means by which insurers, like other plaintiffs, can assert their right to recover losses from those who wrongfully caused them. As Supreme Court Justice Louis Brandeis stated:

> It is essential to the performance of the insurer's service, that the insured be promptly put in funds, so that his business may be continued without embarrassment. . . . In consideration of securing them the right to conduct the litigation, the insurers made the advances. It is creditable to the ingenuity of business men that an arrangement should have been devised which is consonant both with the needs of commerce and the demands of justice.[1]

This right to recovery is critical when it comes to catastrophic property losses that occur in the wake of both man-made and natural disasters.

In recent decades, however, there has been growing encroachment on the property insurer's right to redress, as a result of various contractual, common law, and statutory mechanisms. Subrogation waivers contained in construction contracts have provided contractors, subcontractors, architects, and engineers with a nearly impenetrable shield against suits by a property owner's insurer; the common-law antisubrogation rule steps in to bar subrogation where the tortfeasor is an additional insured under a property owner's insurance policy. The common-law "Act of God" defense affords tortfeasors a safe haven in the wake of natural catastrophes, and various governmental immunity statutes and doctrines exist that shield public entities from liability after one occurs. Finally, the economic loss doctrine has evolved to close still other loopholes in tortfeasor liability to a subrogated insurer.

Despite this sobering picture of the growing limits on insurers' right to redress, the law of subrogation is still alive and well. For every obstacle created by the courts or the legislatures, there is a possible path around it. This article highlights some of the main obstacles property insurers encounter in attempting to subrogate after a catastrophic loss, and how to surmount them.

Subrogation Waivers

One of the most formidable obstacles confronting the property insurer seeking to subrogate in the wake of construction catastrophe is the subrogation waiver. Currently most contracts between commercial owners and contractors, subcontractors, architects, designers, and engineers are fortified with language that gives broad immunity from subrogation to all of these parties in the event of fire or other loss arising from the construction.

AIA Contractor Agreement

Language in the most commonly used contracts is not an invention of the parties themselves but is adopted from the American Institute of Architects' (AIA) General Conditions of the Contract for Construction, A201. When created in 1911, the A201 consisted of only two pages and was a model of clarity and concision.[2] The document, however, has undergone 15 revisions, now numbers 44 pages, and has become perhaps the most widely used and plagiarized document in the world. The A201 document is a general conditions form that is only one of the contract documents forming the construction contract. In addition it is frequently incorporated by reference into a variety of other agreements, such as owner-architect, owner-construction manager, contractor-subcontractor, and architect-consultant agreements and contracts. It is a keystone for coordinating the many parties involved in the construction process and allocating proper legal responsibilities.

The centerpiece of the document itself, at least as far as insurer's rights are concerned, is the subrogation waiver contained in Article 11. Given its broad construction by a majority of jurisdictions, the waiver can tie the hands of insurers attempting to recover for construction-related losses caused by any of the parties involved in a construction project.

The 1997 edition of the A201 document contains several key provisions that together define the rights and defenses of owners, architects, and construction contractors and subcontractors when it comes to litigation in the wake of a construction-related catastrophe. The document defines "work" as follows:

> 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.

Article 11 allocates the risks of the parties regarding insurance and subrogation:

> **11.1. CONTRACTOR'S LIABILITY INSURANCE**
>
> **11.1.1.** The Contractor shall purchase and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from

claims set forth below which may arise out of or result from the Contractor's operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable: . . .
5. Claims for damages, other than to the Work itself, because of injury to or destruction of tangible property, including loss of use resulting therefrom.

Article 11 also requires the owner to obtain property insurance for the specific Work itself:

11.4. PROPERTY INSURANCE
11.4.1. Unless otherwise provided, the Owner shall purchase and maintain, in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located, property insurance written on a builder's "all-risk" or equivalent policy form in the amount of the initial Contract Sum, plus value of subsequent Contract modifications and cost of material supplied or installed by others. . . . 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. . . . This insurance shall include interests of the owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.

11.4.1.1. Property insurance shall be on an "all-risk" or equivalent policy form and shall include without limitation, insurance against the perils of fire (with extended coverage) and physical loss or damage including . . . theft, vandalism, malicious mischief, collapse, earthquake, flood, windstorm. . . .

Finally, the insurance section includes a subrogation waiver:

11.4.7. Waivers of Subrogation. The Owner and the Contractor waive all rights against 1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other and 2) the Architect, Architect's consultants, separate contractors . . . if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Paragraph 11.4 or other property insurance applicable to the Work.

The net effect of these provisions is that the owner must obtain first-party property insurance for damage to the work, the general contractor must obtain liability insurance, and both parties must waive subrogation against each other (including subcontractors). Pursuant to paragraph 11.4.7, the owner agrees to waive all rights against the contractor *to the extent covered by property insurance*.

Damage to "Nonwork" Property

One possible exception to the AIA subrogation waiver is for claims concerning damage to property not included in the "work." Although courts uniformly have upheld the validity of such waivers as they apply to damage to the construction work or the project itself, they have differed on the question of whether the waiver also bars subrogation for damage to property *adjacent* to the work but not part of the construction project. The success of such a claim depends not only on the jurisdiction in which the claim is brought but also on the scope of the policy.

According to majority rule, if the owner insures the contractor under its existing property insurance policy, the waiver bars subrogation for damage to both work and nonwork property. Conversely, if the owner purchases a separate builder's risk policy to insure the work, the owner's insurer can subrogate for damage to nonwork property.[3]

In *Employers Mutual Casualty Co. v. A.C.C.T., Inc.*, a medical center entered into a contract with an asbestos removal company. The parties used the A201 owner-contractor agreement, including the subrogation waiver. To satisfy its insurance obligations under the A201 agreement, the Medical Center relied upon its existing all-risk policy. Consequently, the court held that the Medical Center's insurer was barred from subrogating against the contractor for damage to property not involved in the work after a fire broke out in the abatement area. The court stated that by the terms of the contract, the owner had the option of purchasing an all-risk policy specifically to cover the "work" or of relying on any existing property insurance that would include the work. The waiver clause creates the work/nonwork distinction, according to the court, based upon the owner's decision to purchase a new policy or to rely on the existing one. The court then concluded, "The owner agrees to waive the right to sue for damages done only to the 'work' if it purchases a separate all-risk policy specifically to cover the 'work.'" But if the owner relies on an existing policy, which is so broad that it covers both work and nonwork, the owner waives the right to sue for *all* damages, as long as the "nonwork" damage is covered by the policy.[4]

Under the minority view, by contrast, the waiver provision applies only to the work, regardless of the type of insurance the owner chooses. In *Brisk Waterproofing* the court held, "It makes no difference whether the policy under which subrogation is sought is one which the owner purchased specifically to insure the Work . . . or some other policy covering the owner's prop-

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erty in which the owner has also provided coverage for the Work." In either event, according to the court, the waiver clause, if given its plain meaning, bars subrogation only for those damages covered by insurance the owner provided to meet the requirement of protecting the contractor's limited interest in the building—i.e., damages to the work itself. The court reasoned that where the owner relies on an existing property policy, the contractor is a "constructive insured" under that policy *only to the extent* of its insurable interest. Thus the court explicitly rejected the contractor's argument that the waiver encompasses not only damage to the work itself but also all damages flowing from the work. The ultimate effect of the majority rule is that the scope of the waiver depends more on the nature of the owner's property insurance than on the nature of the property damage.[5]

Strategies for Defeating the Subrogation Waiver

The majority rule leads to the inescapable conclusion that subrogation has a better chance of success where property owners purchase a separate all-risk policy that covers only the work and do not merely rely on an existing property insurance policy.[6]

A core problem is that owners have little incentive to buy a separate property policy—commercial property insurance policies typically cover construction to the property as well as the existing property. Furthermore, commercial entities often do not want to make it even easier for insurers to subrogate because this often involves litigation against a supplier or contractor with whom that owner has an ongoing relationship.

A second possible limitation on the waiver exists where policy language requires the insured to obtain the insurer's permission before waiving its subrogation rights. Courts will give effect to such clauses and invalidate subrogation waivers agreed to without the insurer's permission,[7] but these policies are increasingly rare and, in any event, do not meet an owner's AIA insurance requirements, which waive subrogation.

Despite this sobering picture of the growing limits on insurers' right to redress, the law of subrogation is still alive and well.

A property insurer may be able to defeat the AIA subrogation waiver if the contractor or subcontractors acted with gross negligence. The general rule is that a party may not contract against liability for harm caused by its own gross negligence.[8]

A subrogation waiver is considered an exculpatory clause even if it does not explicitly disclaim liability. In *Indiana Insurance Co. v. Erhlich*, a college's insurer sued a contractor for damage caused when a wall collapsed during construction of a library. The college's contract with the contractor contained a detailed subrogation waiver. Calling the waiver a "release" clause, the court said that although it is not against public policy to contract against liability caused by ordinary negligence, if the insurer could prove that the contractor acted with gross negligence, the waiver would not be enforceable. The court dismissed all of the subrogated insurer's claims except the gross negligence claim.[9]

In *Federal Insurance Co. v. Honeywell*, the court stated, "[W]hile the exculpatory clause in the contract between Broadway and the defendant may shield the defendant from liability for ordinary negligence, it will not protect the defendant from liability for gross negligence." Gross negligence in that context is conduct "that evinces a reckless disregard for the rights of others or 'smacks' of intentional wrongdoing." The court went on to hold that the insurer had established facts sufficient to defeat a motion to dismiss by presenting an alarm inspection report from an expert documenting numerous deficiencies in the installation and maintenance of the alarm system.[10]

Other Obstacles: Anti-subrogation Rule

A fundamental tenet of insurance law is that an insurer may not subrogate against its own insured. Thus, even in the absence of a subrogation waiver, the insurer cannot subrogate against insureds covered by the policy. The California Court of Appeals stated that "by definition, subrogation exists only with respect to rights of the insurer against third persons to whom the insurer owes no duty."[11] To allow subrogation in such cases would permit the insurer to pass on the loss from itself to its own insured and avoid coverage.

Furthermore, it is well established that parties to a contract may mutually agree that one party will obtain insurance as part of the bargain to shift the risk of loss from both of them to the insurance carrier. If loss occurs, they are deemed to have agreed to look to the insurance policy, without regard to which party was negligent, and subrogation is not allowed.[12] The effect of the policy is to make the negligent party an additional insured, a "constructive insured," or a coinsured.[13]

Coinsured or additional insured status for any loss under a policy does

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not automatically insulate the coinsured from subrogation by the insurer for damage to all the property covered, however; it may bar subrogation only to the extent of the coinsured's interest in the property.[14]

New York courts, among others, have recognized this property-based limitation on the antisubrogation rule. In *Paul Tishman Co. v. Carney & Del Guidice, Inc.*, the court held that a contractor's builder's risk insurer could not subrogate against a negligent subcontractor insured under the policy for damage to whatever interest he may have had in the property, such as "the tools, labor and material furnished or owned by the defendant." But, according to the court, the insurer could subrogate for damage to property in which the subcontractor had no interest—his insurable interest was commensurate with his property interest.[15]

As with subrogation waivers, gross negligence may serve to defeat the antisubrogation rule in this context. In *Indiana Erectors, Inc. v. Trustees of Indiana University*, the court noted, "an agreement to insure is an agreement to provide both parties with the benefits of insurance regardless of the cause of the loss (*excepting wanton and willful acts*)."[16]

Subcontractor Liability

Courts differ as to whether the subrogation waiver and terms of the construction contract bar subrogation against a negligent subcontractor. The courts look to the language of the contract and the intent of the contracting parties.[17]

In *Indiana Erectors*, however, the court of appeals held that there was no contractual privity between the insured owner and the subcontractor under the owner's builder's risk policy, and the subcontractor was not a coinsured. Subrogation was thus possible under the terms of the construction contract, which extended the policy's coverage only to general contractors and not to subcontractors.[18]

Where the parties have adopted AIA Document A201 verbatim, however, the contract shows an intent that the waiver of subrogation applies to the subcontractors. Section 11.4.7 clearly provides that the owner and the contractor waive all rights against "each other and any of their subcontractors, sub-subcontractors, agents and employees" and against the "Architect, Architect's consultants, separate contractors . . . if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages." Here again, look for limiting the scope of the waiver to the work.

Liability after Work Is Complete

Once the work is completed, the subrogation waiver no longer applies; contractors, architects, and engineers may be liable for defects in the work. Courts generally have held that liability under a builder's risk policy terminates upon completion of construction.[19] This interpretation is supported by the language of section 11.4 of AIA Document 201, which requires only that the all-risk property insurance covering the contractor be maintained until final payment has been made or no one other than the owner has an insurable interest in the property. This also means that bars against an insurer's suing its own insured are eliminated.[20]

Design or Construction Defect Claims

In a claim for a design or construction defect that causes damage after construction is complete, architects and engineers are generally subject to a professional standard of care similar to that of doctors, lawyers, and other professionals.[21] Thus, an architect or engineer who fails to exercise the same care, skill, and diligence as others in the profession under like circumstances can be held liable.[22] In a majority of jurisdictions, breach of warranty is not an available cause of action against an architect or engineer because these professionals do not impliedly warrant the sufficiency of plans and drawings furnished to the owner. Several jurisdictions have held, however, that the engineer/architect contract does carry an implied warranty of workmanlike performance. In *Tamarac Developer Co. v. Delameter, Freund and Associates*,[23] the Kansas Supreme Court stated, "A person who contracts with an architect or engineer has a right to expect an exact result . . . the duty of the architect is so strong and inherent in the task, we hold it gives rise to an implied warranty of workmanlike performance."

Statutes of Limitations and Repose: An insurer planning to initiate a subrogation action based on a design or construction defect, however, needs to be aware of how the jurisdiction's statute of limitations and statute of repose may limit the time period in which actions can be brought for harm arising from improvements to real property. The statute of limitations requires that an action be brought within a specified period of time after the loss, whereas a statute of

repose requires an action be brought within a specified period after completion of the improvement to real property, regardless of when the loss occurred.

In California, for example, the statute of limitations requires that an action for damage to real property must be brought within three years of the date of loss. However, this three-year limitation is also subject to outside limits placed by the statute of repose, which requires that actions for latent defects in the design, specification, planning, supervision, or construction of an improvement to real property that causes damage be brought within 10 years after the substantial completion of the work.[24]

The three- and 10-year statutes interact, but a practical result of the statutes of limitation for design and construction defects is that they often expire even before the defects cause a loss. Some states, however, are more generous and tack the statute of limitations onto the end of the 10-year statute of repose.[25]

Although New York does not have a formal statute of repose, its common law in effect imposes a six-year statute of repose for negligence actions against architects, engineers, and contractors. The statute of limitation for negligence actions is three years, and the statute of limitation for breach of contract is six years. Generally an action for negligence accrues at the time of the injury, and an action for breach of contract accrues at the time of the breach. But in cases where the plaintiff has contractual privity with the defendant (architect, engineer, or contractor), the cause of action (negligence or breach of contract) accrues at the completion of construction.[26] In an exception the New York Court of Appeals also applied this rule to a plaintiff not in privity of contract where it found "the functional equivalent of privity."[27]

Subrogating against the Public Entity Defendant

Discretionary Function Exception

Subrogation against the federal government is possible under the Federal Tort Claims Act (FTCA), whereby the United States waives sovereign immunity and is liable for tortious acts and omissions "to the same extent as a private individual under like circumstances."[28] Some states such as Iowa have tort claims acts that mirror the federal version and provide that the state is liable to the same extent as a private individual under like circumstances. A major limitation on the waiver of sovereign immunity exists, however, where the government performs a "discretionary function."[29] This exception immunizes the United States against

> any claim based on an act or omission of an employee of the Government . . . based upon the exercise or performance of a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

Dalehite v. United States, and *United States v. S.A. Empresa de Viacao Aerea Rio Grandense* (Varig Airlines) are the seminal Supreme Court decisions construing the discretionary function exception.[30] They hold that discretionary actions undertaken by federal agencies in the performance of governmental functions and duties cannot form the basis for tort liability.

Application of the function is determined by a two-part test: First, the exception covers only acts that are discretionary in nature, i.e., those that involve an element of choice. This "choice" requirement is not satisfied where a federal statute, regulation, or policy mandates the course of action the governmental employee must follow. Second, once the court determines that discretion is involved, there must be a finding that the exception involves the type of discretion the exception is designed to shield, which are government actions and decisions based on "social, economic, and political policy."

The discretionary function exception casts a wide net, immunizing the government from liability in a broad range of situations. For example, in *Miller* the Ninth Circuit held that the discretionary function applied to immunize the U.S. Forest Service from tort liability in its handling of a fire that started with a lightning strike on Forest Service land and then spread to the Millers' property. The court stated, "[T]he Forest Service's decision regarding how to allocate resources in a multiple fire situation involved discretion and the consideration of competing economic and social policies."[31]

A few state courts, however, have held that negligent firefighting does not as a matter of law fall within the discretionary function exception. In *Invest Cast Inc. v. Blaine*, the court stated that while decisions regarding whether to employ firefighting resources and what quantity of resources to expend involve the exercise of a discretionary function, "[h]ow the firefighter personnel actually fight the fire . . . is not within the discretionary function exception. . . .They are tactical decisions without larger policy implications." The plaintiff alleged that the firefighter was negligent due to using a direct stream of water as opposed to a fog pattern, pushing the fire into the main building, and using up the existing water supply without securing an adequate backup supply. In reversing the lower court's grant of summary judgment to the fire department, the court of appeals remanded the case for trial, holding that because the allegations dealt with how the fire was fought, the case did not fall within the discretionary function exception.[32]

Other Governmental Defenses

Courts also have relied on the public duty doctrine to absolve public entities of liability. Under that doctrine, a governmental entity is exempt from liability for the negligence of its officers or employees if it owes a duty to the general public as opposed to an individual plaintiff. Some courts have held, however, that where a state tort claims act is applicable, it clearly excludes the public duty doctrine.[33]

In Minnesota, for example, the court established a four-factor test to determine at what point a city assumes a duty to act for the protection of an individual, not the general public. The requirements are that (1) actual knowledge of the dangerous condition exists; (2) plaintiffs reasonably relied on the municipality's representations to decide to forgo other alternatives of protecting themselves; (3) an ordinance or statute clearly sets forth mandatory acts for the protection of a particular class of persons rather than the public as a whole; and (4) the municipality must use due care to avoid the risk of harm.[34]

Government Liability for Negligent Inspection

One avenue for subrogation against a governmental entity in the wake of a catastrophic loss may be a negligent inspection claim. Negligent inspection is frequently based on the "good Samaritan" theory of liability as defined by section 324A of the *Restatement (Second) of Torts*. Many states have adopted the *Restatement* formulation and imposed a duty on private and governmental parties to conduct inspections with reasonable care in such contexts as insurance company and municipal fire inspections.[35] Under section 324A, two scenarios may cause an inspector or regulator to be liable for negligent inspection: The inspector, in undertaking the duty, must have increased the risk or harm, or the party being inspected must have relied on the inspection to ensure safety. The latter provision is the most common basis for liability. Some courts, however, narrowly define "reliance" to mean that the plaintiffs must depend exclusively on the inspectors for protection and must forgo other remedies or precautions.[36]

Recovering after Natural Disasters

The Act of God Defense

> One who knows the Mississippi will promptly aver—not aloud, but to himself—that ten thousand River Commissions . . . cannot tame that lawless stream, cannot curb it or confine it, cannot say to it, Go here, or Go there, and cannot make it obey; cannot save a shore which it has sentenced.

As Mark Twain in *Life on the Mississippi* so dramatically described, the age-old "Act of God" defense is certain to be encountered by insurers attempting to subrogate against a tortfeasor in the wake of a natural catastrophe. For three centuries the defense has been accepted in negligence and strict liability cases. The classic examples of cases in which this defense appears involve flooding, blizzards, lightning strikes, and earthquakes. (See sidebar on page 53.)

The Alabama Supreme Court recently defined the defense as follows: "In its legal sense an 'Act of God' applies only to events in nature so extraordinary that the history of climatic variations and other conditions in the particular locality affords no reasonable warning of them."[37] In addition to unforeseeability, the defendant has the burden of proving by a preponderance of the evidence that the natural disaster was the sole proximate cause of the harm. Based on this standard, courts have held that the following incidents could not be ruled Acts of God: the collapse of a roof due to an accumulation of snow and ice, falling ice from a passing truck that struck a car's windshield and injured a passenger, and freezing and thawing of the soil that caused a gas pipe to break and injure plaintiffs.[38]

Limitations on the Defense

Superceding or intervening force: There are several avenues for circumventing the Act of God defense. For example, where the defendant acted negligently, the Act of God defense will fail unless the defendant can prove that the Act of God was a "superseding, supervening force, obliterating all other causes brought about by the defendant."[39] The superseding and supervening (or intervening) act of nature must occur *after* the tortfeasor's negligence and must actively produce the harm. Where the alleged intervening cause merely created a condition acted upon by the defendant's negligence, the alleged intervening cause is not the proximate cause of the damages.[40]

Section 451 of the *Restatement (Second) of Torts* also provides a means for overcoming the Act of God defense: The tortfeasor cannot be relieved of liability by a force of nature *unless* the force of nature causes a harm different from the harm risked by the tortfeasor's negligence.

Joint causation: Where the defendant's negligence combines with a natural phenomenon in such a way as to *increase* the damage, the defense will fail. An example of this type of joint causation was reflected in the damage caused by Hurricane Andrew, which leveled parts of Florida in 1992. The unusual ferocity of the storm was only one of several factors to blame for the storm damage—others were inappropriate design, weak building materials, poor construction techniques, and inadequate inspec-

tion.[41] According to *Restatement* section 450, negligent actors may be liable under such situations: "[A] force of nature, which merely increases or accelerates harm to another which would otherwise have resulted from the actor's negligent conduct, does not prevent the actor from being liable for such harm." Where it is possible to allocate the damages to both natural disaster and human negligence, courts have done so.[42]

The Act of God defense has narrowed in recent decades as the concepts of foreseeability and negligence have broadened.[43] It has been said that if the harm might have been *avoided* by human prudence, foresight, and reasonable care on the part of the defendant that was not exercised, the defendant can be held liable. Taking precautions against normal conditions may no longer be adequate if abnormal conditions are reasonably foreseeable. And because some natural disasters like hurricanes, tornadoes, earthquakes, and blizzards, are foreseeable, the duty of reasonable care threatens to swallow the defense. As the Georgia Court of Appeals recognized, lightning striking a utility wire is an Act of God, but failing to ground the line is "not an act free from human agency."[44]

In response to the threat of various natural disasters, ordinances, building codes, and even legislation have been enacted to minimize risks. For example, in the wake of the 1991 California wildfires, a law requiring a 30-foot brush clearance around buildings in fire-prone areas was enacted. California has imposed grading requirements to minimize the risk of landslides and subsidence. Tough building codes have increased earthquake resistance. Although compliance with such codes can minimize damage from these disasters, noncompliance can be a contributing cause that results in liability on the part of human actors. The good news for insurers seeking to hold defendants liable in the wake of a natural catastrophe is that increasingly, forces of nature are not synonymous with Acts of God under the law.[45]

Subrogating after a Fire: Theories and Defenses

Subrogating in the aftermath of a catastrophic fire is ordinarily a viable means for an insurer to recover damage claims paid to its insured. As pointed out above, however, in numerous instances, subrogation may be blocked by a subrogation waiver, the antisubrogation rule (where the insured is the negligent party), or the simple difficulty of proving the cause and origin of the fire. In any of these situations, fire spread theories may provide an alternate avenue of recovery. Even in instances where subrogation is viable, however, fire spread theories may provide an *additional* avenue of recovery where the scope and extent of the damage caused by the fire is worse than it should be given its origin.

The stakes in subrogation suits are increasing for both property insurers and potential defendants.

During the past two decades, plaintiffs have resorted to fire spread theories, also known as "enhanced burning" theories, in an attempt to pin liability on tortfeasors whose negligence enhanced the scope and intensity of the fire (whether or not the negligence created the source of ignition). In such cases the resultant injury or damage to property can be attributed to factors such as the presence of highly flammable contents or building materials, the failure of fire-suppression or alarm systems, or negligent construction. Adjacent landowners and contractors can be liable for fire spread under theories of negligence and nuisance. Other possible subrogation targets in this context include service contractors, who may be liable for negligent installation of services, and inspectors and municipalities, that may be liable for breaching their duty to protect against fire.

Ultimately in such cases, liability is predicated on theories of proximate and concurrent causation. If defendants can prove that their conduct was not the proximate cause of the damage, however, they can provide a good defense to these liability theories.

Spread Theories of Liability

Product liability and negligence: An in-depth examination of a building in the aftermath of a fire often reveals products that performed poorly in the fire and contributed to its spread. Many finishing and insulating materials have flammable characteristics: paper-based sheathing, blown-in recycled paper insulation, urethane foam insulation, wall and cabinet laminates, and even vinyl siding. The most significant fire litigation settlements of the past two decades pinned liability on the manufacturers of oil-based, flammable, plastic building material that enhanced spread, such as polyvinyl chloride (PVC), styrenes, synthetic rubbers, and polyurethane foams. In the 1980 fire at the Stouffer's Inn in Harrison, N.Y., for example, which had damages of $48.6 million, the PVC wallcovering contributed to the spread of the fire—and consequently, the plastics manufacturers contributed to the settlement. This was also the

Although the waivers, immunities, and defenses discussed above present challenges for insurers attempting to recover, they are not fatal.

case in the1981 fire at the Las Vegas Hilton Hotel, where plaintiffs claimed that PVC products and synthetic carpeting were to blame for the fire spread.[46]

Insurers also may be able to recover against manufacturers of fire alarm or sprinkler systems if the systems contributed to the spread of fire by failing to meet expectations or design and performance criteria. In *La Barre v. Mitchell*, for example, an alarm manufacturer was held liable on product liability theories in the wake of a fire that destroyed a commercial building. The plaintiff's theory was that the alarm horns failed to sound because wires controlling early detection and fire extinguishment were burned through by the fire. The court held the manufacturer liable for a product defect, despite acknowledging "the product's failure was not a direct cause of the damage to plaintiffs' property."[47]

Fire spread theories also may be based on negligent design or construction where the location or absence of fire walls enhanced the spread. In *American States Insurance Co. v. Caputo*, the owner of a building in a shopping center that was damaged by fire sued the builder for negligent design and/or construction because the builder failed to install fire-stops and this caused the fire to spread. The jury found the builder not negligent, but the court of appeals reversed and remanded the case for a new trial holding that the trial court abused its discretion by failing to instruct the jury on "concurrent causation." The court stated, "If the defendant's original negligence continues to the time of injury and contributes substantially to the harm caused, an intervening, contributing negligent act does not absolve the original tortfeasor from liability. Each may be a proximate, concurring cause for which full liability may be imposed."[48]

Courts also have pinned liability on installers of fire-related products such as fire alarms if the alarms were not installed in a reasonable manner. However, courts also have upheld contractual provisions limiting the amount of damages an installer may be liable for in negligently installing or maintaining a fire alarm system.[49] To recover in strict liability against the installer, the plaintiff must show that the installer supplied, sold, or assembled the product. But if the business simply installed the system according to the specifications of a third party, the installer cannot be held strictly liable.[50]

Adjacent landowner or construction site: The owner or possessor of property owes a duty of care to neighbors and property that can become the basis of liability in a fire spread situation. Determining the actual cause of the fire is not a prerequisite to liability; establishing that the adjacent landowner negligently maintained his or her premises can be enough to satisfy a proximate-cause inquiry.[51]

Often, however, the existence of this duty hinges on foreseeability, which is usually a fact-based determination. Furthermore, just as an alarm company may be liable to a property owner for negligent installation, it also may owe a duty of reasonable care to nearby landowners despite the absence of privity. Here, foreseeability is the governing, or perhaps limiting, principle.[52]

Defenses to Fire Spread Liability

Implied waivers: Just as the trend in the construction industry is to limit the subrogation rights of insurers through the use of waivers, so too in the commercial-lease context, the trend is toward limiting subrogation when losses are covered by insurance.[30]

A commercial lease typically includes a clause providing that the landlord and tenant agree to look only to insurance in the event of loss and not pursue claims against each other that are covered by insurance. Even in the absence of an express waiver, however, courts are willing to find implied waivers of subrogation in commercial leases. They have reached this result using various theories, most commonly the theory that the lessee/negligent party is a coinsured. Under the antisubrogation rule discussed above, the lessor's insurer will be prevented from subrogating against the lessee if that party is a coinsured. This theory is also known as the "Goldman effect," after *General Mills, Inc. v. Goldman*, 184 F.2d 359 (8th Cir. 1950), *cert. denied*, 340 U.S. 947 (1951), the seminal case in which the court barred subrogation by a landlord's insurer attempting to sue a tenant to recover for fire damage to the landlord's property that a tenant's employee negligently caused. The court held that the lease showed an intent for the tenant to benefit from the landlord's insurance, and the tenant therefore was not liable to the landlord's insurer for fire loss.[53]

Recent cases expand the implied waiver theory even further. *Sutton v. Jondahl*[54] frequently is cited for the proposition that in the absence of a contrary agreement, the tenant is presumed to be a coinsured under the landlord's policy. The *Sutton* court based its reasoning on four factors: (1) both the landlord and

tenant have an insurable interest in the premises; (2) the tenant in effect pays for the premiums as part of the rent; (3) the tenant reasonably relies on the landlord to provide fire protection and insurance; and (4) it is equitable to place the risk on the insurer that has been paid premiums for assuming the risk.

Although a majority of jurisdictions have adopted the theory of implied subrogation waivers for leases, a few have stood firm in rejecting it. The Kentucky Supreme Court in *Britton v. Wooten*[55] held that because "'[p]ublic policy' disapproves of exculpating agreements in derogation of tort liability," an agreement should be so interpreted only if it is quite explicit.

Economic loss doctrine: Perhaps the most formidable common law limitation on an insurer's right to subrogate in the wake of a fire or other property loss where the action is based on product liability theories is the economic loss doctrine. The basic premise of the doctrine—which is statutory in several states—is that purely economic loss suffered due to a product or construction defect is recoverable in contract only, in the absence of personal injury or damage to "other property." Economic loss generally includes the diminution in value of an item due to its defective nature, the cost of repair, replacement cost, and the consequent loss of use or lost profits. A subrogee is bound by the terms of any warranty disclaimers and limited remedies that may have accompanied the defective product unless it can prove damage to property other than the product itself. If the defect and the damage are one and the same, the defect is not considered damage recoverable in tort.[56]

In the context of fire spread litigation, damage to "other property" often is sufficient to circumvent the doctrine and permit an insurer to maintain tort causes of action against the manufacturer or the builder. But some states have narrowed this exception almost out of existence. In Michigan, for example, to fit within the other property exception, the plaintiff must prove that the damages are not direct consequential losses that were within the contemplation of the parties and therefore could have been the subject of negotiations between the parties. The courts were concerned that construing the exception too broadly would swallow the rule, because in many cases a defective product will necessarily cause damage to other property.[57]

Michigan courts have made it difficult for a plaintiff to allege that damage was unforeseeable because the law focuses on the nature of the

Acts of God: A Brief History

One of the first mentions of the defense is in a 16th century opinion, Shelley's Case, in which the court stated, "It would be unreasonable that those things which are inevitable by the Act of God, which no industry can avoid, nor policy prevent, should be construed to the prejudice of any person in whom there was no laches." It emerged again in *Rylands v. Fletcher*, where Lord Blackburn stated, "[Defendant] can excuse himself by showing that the escape [of water] was owing to the plaintiff's default; or perhaps that the escape was the consequence of . . . the Act of God."

In American jurisprudence, the Act of God defense requires two elements: (1) an unusual, extraordinary, and unexpected manifestation of the forces of nature that (2) is the sole cause of the damage. If a similar event occurred before, could be anticipated with modern technology, or is otherwise reasonably foreseeable, the Act of God defense will fail. Thus, the defense is limited to truly unforeseeable events, rather than situations that involve unusual, but not unprecedented, events.

These and many other cases detailing the development of law surrounding Acts of God can be found in Denis Binder's *Act of God or Act of Man? A Reappraisal of the Act of God Defense in Tort Law*, which appeared in REVIEW OF LITIGATION, volume 15 (Winter 1996).

damage, not its extent or magnitude. In *Detroit Edison* the Sixth Circuit barred tort claims arising from an explosion at an electric utility caused by a defective pipe. The plaintiffs claimed that the damage was so extensive, that it was not only a commercial disappointment but also a disaster that required tort remedies. The court rejected this argument, stating that the economic loss doctrine "focuses our inquiry not so much on the magnitude or extent of the damage as on the parties involved and the nature of the product's use."[58]

In a more extreme case, the Michigan Court of Appeals blocked the tort claims of an industrial school suing a lighting retailer for property damage resulting from a fire caused by a defective light. The court cited the fact that both the school and the retailer were commercial entities with the "knowledge and ability to allocate liability in their purchase and sale agreement." Further, according to the court, the consequences of the product's potential failure were likely to have been within the contemplation of the parties when they entered into the agreement for the sale of the light fixture.[59] The Michigan federal district court echoed this view, stating, "Fires caused by electrical products are simply not beyond the contemplation of commercial entities."[60]

Conclusion

The stakes in subrogation suits are increasing for both property insurers and potential defendants. Industrial and commercial catastrophic losses can reach into the hundreds of millions of dollars. Although the waivers, immunities, and defenses discussed above present challenges for insurers attempting to recover, they are not fatal. The equitable and contractual right to subrogation is here to stay—but it is for the lawyers to figure out how to maneuver around these obstacles in order to best assert the insurer's fundamental right to redress. ■

Notes

1. Luckenback v. W.J. McCahan Sugar Refining Co., 248 U.S. 139, 149 (1918).

2. Portions of the A201 subrogation waiver quoted in this article are from the 1997 edition; many of the cases quoted use the1987 edition of the document, which is nearly identical.

3. *See, e.g.*, Rahr Malting Co. v. Climatic Control, Co., 150 F.3d 835 (8th Cir. 1998); Employers Mutual Cas. Co. v. A.C.C.T., Inc., 580 N.W.2d 490 (Minn. 1998).

4. *See Employers Mutual*, 580 N.W.2d at 490. The Minnesota Court of Appeals recently extended this rule, holding that an endorsement is part of an existing property policy and cannot "stand" on its own. Indep. Sch. Dist. 833 v. Bor-Son Constr., Inc., 631 N.W.2d 437 (Minn. Ct. App. 2001).

5. S.S.D.W. Co. v. Brisk Waterproofing, Co., 556 N.E.2d 1097 (N.Y. Ct. App. 1990).

6. *See, e.g.*, Fidelity & Guar. Ins. Co. v. Craig-Wilkinson, Inc., 948 F. Supp. 608 (S.D. Miss. 1995) *aff'd*, 101 F.3d 699 (5th Cir. 1996).

7. *See, e.g.*, ICC Indus., Inc. v. GATX Terminals Corp., 690 F. Supp. 1282, 1286 (S.D.N.Y. 1988); Aluminum Prod. Distribs., Inc. v. AAAcon Auto Trans., Inc., 404 F. Supp. 1374, 1377 (W.D. Okla. 1975), *aff'd*, 549 F.2d 1381 (10th Cir. 1977).

8. *See, e.g.*, Federal Ins. Co. v. Honeywell, Inc., 663 N.Y.S.2d 247 (N.Y. App. Div. 1997).

9. *See* Indiana Ins. Co. v. Erhlich, 880 F. Supp. 513, 520 (W.D. Mich. 1994).

10. *Honeywell*, 663 N.Y.S. 2d at 248.

11. St. Paul Fire & Marine Ins. Co. v. Murray Plumbing & Heating Corp., 135 Cal. Rptr. 120, 126 (Cal. Ct. App. 1976).

12. *See* Fairchild v. W. O. Taylor Commercial Refrig. & Elec. Co., 403 So. 2d 1119, 1120 (Fla. Ct. App. 1981).

13. Under the antisubrogation rule, an insurer is not entitled to subrogate against its own insured for payments covered by a different policy. *See, e.g.*, Nat'l Union Fire Ins. Co. v. Engineering-Science, Inc., 884 F.2d 1208, 1210 (9th Cir. 1989).

14. *See* Jay M. Zitter, *Insurance: Subrogation of Insurer Compensating Owner or Contractor for Loss under "Builder's Risk" Policy Against Allegedly Negligent Contractor or Subcontractor*, 22 A.L.R. 4th 701 (2000).

15. 316 N.E.2d 875 (N.Y. 1974).

16. 686 N.E.2d 878, 880 (Ind. Ct. App. 1997) (emphasis added).

17. *See, e.g.*, Atlas Assurance Co. v. General Builders, Inc., 600 P.2d 850 (N.M. Ct. App. 1979).

18. *See also* W. Wash. Corp. of 7th Day Adventists v. Ferrellgas, Inc., 7 P.3d 861 (Wash. Ct. App. 2000).

19. *See Fairchild*, 403 So. 2d at 1121.

20. *See, e.g.*, Hendricks v. Great Plains Supply Co., 609 N.W. 2d 486 (Iowa 2000), discussed in 36 TORT & INS. L.J. 571 (2001).

21. *See, e.g.*, Mounds View v. Walijarvi, 263 N.W.2d 420 (Minn. 1978).

22. *See* Jeffrey W. Coleman, *Liability of Design Professionals*, Construction Institute, Minn. Inst. of L. Edu., § V (1987), at 1.

23. 675 P.2d 361, 365 (Kan. 1984).

24. *See, e.g.*, CAL. CODE CIV. PROC. §§ 338, 337.15 (2003).

25. *See, e.g.*, MINN. STAT. § 541.051, sub. 2 (2002).

26. Sears Roebuck & Co. v. Enco Assocs., 372 N.E.2d 555, 557 (N.Y. 1977).

27. City Sch. Dist. v. Hugh Stubbins & Assocs., 650 N.E.2d 399, 400 (N.Y. 1995).

28. 28 U.S.C. §§ 2671-2680 (2003).

29. *See* Miller v. United States, 163 F.3d 591 (9th Cir. 1998).

30. 346 U.S. 15 (1953); 467 U.S. 797 (1984).

31. *Miller*, 163 F.3d at 597.
32. *Invest Cast*, 471 N.W.2d at 368 (Minn. Ct. App. 1991).
33. *See, e.g.*, Adam v. State, 380 N.W.2d 716 (Iowa 1986). *But see* Kolbe v. State, 625 N.W.2d 721 (Iowa 2001).
34. *See* Cracraft v. St. Louis Park, 279 N.W.2d 801, 806-07 (Minn. 1979).
35. *See, e.g.*, Jefferson County School Dist. v. Justus, 725 P.2d 767, 772 (Colo. 1986). *But see Cracraft*, 279 N.W.2d at 801.
36. *See* Blessing v. United States, 447 F. Supp. 1160, 1197-1200 (E.D. Pa. 1978).
37. Bradford v. Stanley, 355 So. 2d 328 (Ala. 1978).
38. *See* Teeple v. State Farm Ins., 1988 Tenn. App. LEXIS 268 (Tenn. Ct. App. 1988).
39. *See* Smith v. Bd. of County Road Comm'rs, 161 N.W.2d 561, 562 (Mich. 1968).
40. *See* Bishop v. S. Tex. Elec. Co-op, Inc. 577 S.W.2d 331 (Tex. Ct. App. 1979).
41. Steven T. Maher, *Emergency Decisionmaking During the State of Florida's Response to Hurricane Andrew*, 17 NOVA. L. REV. 1009, 1011 (1993).
42. *See* Rix v. Alamogordo, 77 P.2d 765, 770 (N.M. 1938).
43. Denis Binder's *Act of God or Act of Man? A Reappraisal of the Act of God Defense in Tort Law*, 15 REV. LITIG. 1, 5, 8, 13 (Winter 1996).
44. Cent. Ga. Elec. M'ship Corp. v. Heath, 4 S.E.2d 700 (Ga. Ct. App. 1939).
45. *See* Binder, *supra* note 43.
46. *See In re* Stouffer's Corp. Bldg. Fire, MDL 487; *In re* Las Vegas Hilton Hotel Fire, A206777.
47. 681 N.Y.S.2d 653 (N.Y. App. Div. 1998).
48. 710 N.E.2d 731 (Ohio Ct. App. 1998).
49. *See, e.g.*, *Scott & Fetzer*, 493 N.E.2d at 1027 (Ill. 1986); North River Ins. Co. v. Jones, 655 N.E.2d 987 (Ill. Ct. App. 1995).
50. Suvada v. White Motor Co., 210 N.E.2d 182 (Ill. 1965), *overruled on other grounds by* Dixon v. Chicago, 601 N.E.2d 704, 711 (Ill. 1992).
51. *See, e.g.*, Fireman's Fund Ins. Co. v. Aalco Wrecking Co., 466 F.2d 179 (8th Cir. 1972); *but see* Bartelli v. O'Brien, 718 N.E.2d 344 (Ill. App. Ct. 1999).
52. *See Scott & Fetzer*, 493 N.E.2d at 1022.
53. *See* Ann Peldo Cargile, *Implied Waivers of Subrogation in Leases*, PROB. & PROP. (Jan./Feb. 1998), at 23.
54. 532 P.2d 478 (Okla. Ct. App. 1975).
55. 817 S.W.2d 443, 447 (Ky. 1991).
56. *See* Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 895 (1989).
57. Neibarger v. Universal Co-ops, 486 N.W.2d 612, 620 (Mich. 1992).
58. 35 F.3d at 242.
59. MASB-SEG Prop./Cas. Pool, Inc. v. Metalux, 586 N.W.2d 549 (Mich. Ct. App. 1998), *appeal denied*, 616 N.W.2d 170 (Mich. 1999).
60. Mich. Mut. Ins. Co. v. Osram Sylvania, Inc., 897 F. Supp. 992, 995 (W.D. Mich. 1995).