

## **AFFIRMATIVE DEFENSES & MEASURE OF RECOVERY**

### **I.**

#### **Introduction**

As a general rule, insurers seeking to recoup their losses by subrogating against responsible third parties, stand in the shoes of their insured and obtain no greater rights than their insured. The result of this rule is that any defense that could be raised against an insured may also be raised against the subrogating carrier.<sup>1</sup> Defense counsel may raise several affirmative defenses to defeat an insurer's subrogation rights, including asserting that the statute of limitations has run or that a valid waiver of subrogation exists or other limitations of liability.

Additionally, defense counsel may contest the amount and measure of recoverable damages. Insuring that recovery representatives and adjusters are maximizing damages for which recovery is sought by way of negotiation, arbitration, or trial is a several step process. All of us familiar with subrogation claims are well aware that almost every claim resolved will have a discount attached due to the liability dispute. The parties will usually come to either a figure or a range of potential recovery from which to start the claim resolution process. Therefore, we certainly want to start with the maximum provable damage claim that we can legitimately advance under the law. The goal is to have our damage figure and measure of recovery well documented and established such that it can be used a solid starting point for negotiation.

---

<sup>1</sup> National Fire Insurance Co. of Hartford v. Daniel J. Keating Co., 35 F.R.D. 137 (W.D. Pa. 1964).

## II.

### **Affirmative Defenses**

#### *a. Statute of Limitations*

A statute of limitations sets a maximum period of time for bringing a legal action after damage has occurred. Limitation of actions is controlled by statute and every state/country has a comprehensive set of statutes setting forth the period of limitations for all, or substantially all, actions within the state which arise either by virtue of statute or common-law principles.

Statute of limitations are triggered and will begin to run at certain times depending on the nature of the claim. For example, if the cause of action asserted is based in tort, most countries agree that the date of discovery of the damage will trigger the running of the statute. To illustrate, let's assume a building was damaged by fire and that the fire was caused by faulty electrical wiring installed by an electrician during the construction of the building two years ago. Let's further assume that we are in the State of California which has a three year statute of limitations for bringing actions based on negligence. Based upon these assumptions, a negligence lawsuit against the electrician must be brought within three years of the date of the fire. In a product liability action, the statute may begin to run on the date of delivery, the date when the product failed, or the date when the damage was discovered. In a contract action, the running of the statute may vary from the date of signing the contract to the date of the breach.

In any event, the applicable statute of limitation sets the maximum period in which an action can be brought. If an injured party files a lawsuit after the limitations period has expired, defense counsel can raise the statute of limitations as an affirmative defense and this will have

the effect of barring the injured party from litigating their claim. To prevent this defense from being available in our subrogation actions, it is extremely important that the loss be provided to subrogation counsel as early on as possible.

*b. Waivers of Subrogation & Limitations of Liability*

Subrogation rights may be lost if: (1) the insurance company, by conduct or agreement, waives its subrogation rights; or (2) exculpatory or waiver clauses entered into by an insured relieve the tortfeasor from liability. Adjustors, recovery supervisors, and counsel must avoid a mechanical response of merely looking to see whether a written waiver or conduct exists without a thorough analysis of the provision, if in writing; what truly was intended to be waived; or what is legal in the jurisdiction.

Most commercial form leases and construction contracts, and many residential leases, contain clauses that provide for the waiver of the insurer's subrogation rights. A several step analysis of any purported waiver can assist the insurer in determining the likelihood of its enforceability by the courts.

First, the effectiveness of the waiver provision depends upon the specific wording used in the agreement. Often times, the waiver entered into by the insured is contingent upon the insurer's consent to the waiver. Obviously, if the policy language does not permit the insured to waive subrogation rights, or the policy is silent, an argument can be advanced that the waiver is unenforceable.<sup>2</sup>

---

<sup>2</sup> See, for example, Cucchi v. Rollins Protective Serv. Co., 377 Pa. Super. 9, 546, A.2d 1131 (1988), rev'd. on other grounds, 524 Pa. 514, 574 A.2d 565 (1990) (where one party failed to sign the contract as required by its terms, that party cannot claim the benefit of exculpatory provisions).

Second, the insured's failure to notify its insurer of the waiver may be grounds to defeat its enforcement. Recent case law has established that an insurer may not be bound by a waiver of subrogation to which it was not a party and of which it was not aware.<sup>3</sup>

Third, the timeframe that the waiver provision encompasses as well as the scope of the waiver should be analyzed. In construction contracts, for example, a waiver may only be valid during the time that the parties have an insurable interest, i.e., during the construction of a project. Once the project is completed, the original allocation of risk - including the waiver of subrogation provision in the contracting agreements - may no longer apply.<sup>4</sup>

Another argument involving the timeframe of a waiver of subrogation can be fashioned concerning negligent conduct of a landlord that occurred prior to the landlord and tenant entering into a lease agreement that contains a waiver of subrogation. If the language of the waiver of subrogation provision is not clear as to the conduct involved in the waiver, the subrogating carrier can argue that the lease agreement contemplated a status that would occur in the future because the engagements undertaken are to be performed in the future, not the past.<sup>5</sup>

---

<sup>3</sup> Zurich American Insurance Co. v. Eckerd, 770 F. Supp. 269 (E.D. Pa. 1991); ICC Industries, Inc. v. GATX Terminals Corp., 690 F. Supp. 1282, 1286 (S.D.N.Y. 1988) (applying New Jersey law); Seamless Floors by Ford, Inc. v. Value Line Homes, Inc., 438 S.W.2d 598, 601-02 (Tex. App. 1969); Continental Insurance Co. v. Washeon Corp., 524 F. Supp. 34, 36 (E.D. Mo. 1981); and Alamo Chemicals Transportation Corp. v. M/V Overseas Valdes, 469 F. Supp. 203, 212 (E.D. La. 1979).

<sup>4</sup> Fairchild v. W.O. Taylor Comm. Refrig. & Elec. Co., 403 So.2d 1119 (Fla. Ct. App. 1981) (where damage allegedly caused by negligent installation of an air conditioning unit occurred five years after installation was complete, the Court found no consideration for plaintiff/homeowner's ongoing obligation to continue to insure his home for the subcontractor's benefit).

<sup>5</sup> Employers Liability Assurance Corp. v. greenville Businessmen's Association, 224 A.2d 620 (Pa. 1966) (Pennsylvania Supreme Court held invalid exculpatory clause in lease because lease agreement did not specify that it applied to conduct that occurred before as well as after the execution of the agreement). (It should be noted that the clause in Greenville was an exculpatory clause, not a waiver of subrogation, and was construed strictly).

Fourth, waivers of subrogation may also be considered "exculpatory clauses" in that they seek to relieve the wrongdoer of liability for injury or damage prior to the occurrence of the injury or damage. Thus, waivers of subrogation, like exculpatory clauses, must be measured against the strict specificity requirement typically set forth by the courts.<sup>6</sup> Where the language does not express an intention to insulate a defendant from "all liability" but is limited to certain types of liability, the exculpatory clause will not exculpate the party from liability for an event not specifically addressed by the exculpatory clause.<sup>7</sup> Exculpatory provisions are often not enforceable where there may be a showing of gross negligence, willful or wanton misconduct, or intentional torts such as fraud, intentional misrepresentation and conversion.<sup>8</sup>

Insurers can waive their subrogation rights by language in their insuring agreement or by their own conduct. Many policies contain waivers of subrogation provisions as part of their preprinted clauses or by endorsement. These provisions are usually upheld.<sup>9</sup> However, a careful review of the language as noted above should define the extent and scope of the waiver.

---

<sup>6</sup> Nevil Chemical Co. v. Union Carbide Corp., 422 F.2d 217 (3rd. Cir. 1979); Galligan v. Arovitch, 421 Pa. 301, 219 A.2d 463 (1966). It must be noted sound argument can be advanced that waivers of subrogation are simply risk-shifting agreements between businessmen. As such, they should not be analyzed strictly as exculpatory clauses. See generally, Mayfair Fabrics v. Henley, 234 A.2d 503, 507-08 (N.J. Super. Law Div. 1967), aff'd, 246 A.2d 749 (N.J. App. Div. 1969).

<sup>7</sup> Ultimate Computer Services, Inc. v. Biltmore Realty Company, Inc., 183 N.J. Super. 144, 443 A. 2d 723 (1982).

<sup>8</sup> See, e.g. cases cited in Annot. 37 ALR 4th 47 "Liability of Persons Furnishing, Installing or Servicing Burglar or Fire Alarm Systems For Burglary or Fire Losses"; Federal Insurance Co. v. Honeywell, Inc., 641 F. Supp. 1560 (S.D.N.Y. 1986); Markap, Inc. v. Wells Fargo Alarm Services, 427 So. 2d 332 (Fla. Ct. App. 1983).

<sup>9</sup> Fidelity Phoenix Fire Insurance Co. v. Forest Oil Corp., 141 So.2d 841 (La. App. 1962).

An insurance company may also waive its right of subrogation by conduct after the loss inconsistent with its intention to exercise its subrogation rights.<sup>10</sup> This conduct includes inaction such as the carrier's failure to intervene in an action filed by its insured against the tortfeasor.<sup>11</sup>

To evaluate written waivers of subrogation, a close and detailed analysis of the language must be employed. Waivers can be circumvented if the language used is imprecise, broad or contingent. The waiver may also be challenged as an exculpatory clause that must be strictly construed; and avoided where there is a showing of gross negligence or willful and wanton misconduct. An insurer also must avoid acting in a manner that may result in waiver by conduct.

## II.

### **Proof & Measure of Recovery**

It is important to recognize differences in the proof and measure of damages recoverable under the insurance policy as opposed to the proof and measure of damages recoverable from a third-party tortfeasor. Insuring that recovery representatives and adjusters are maximizing damages for which recovery will be sought in a subrogation action is a three step process.

The first step is early recognition in a particular file of subrogation potential. Such early recognition is critical to the investigation of liability issues and preservation of evidence, but it is also important for damages. While the company's obligations to adjust the loss and pay the claim are determined by the policy, it is important for all involved to understand that eventually we

---

<sup>10</sup> Fireman's Insurance Co. v. Georgia Power Co., 181 Ga. 621, 623, 183 S.E. 799 (1935); 38 A.L.R.2d at 1095. See also, Annot. "Waiver By Insurance Company Of Rights To Subrogation", 16 A.L.R. 2d 1269.

<sup>11</sup> For example, in Gallashaw v. Streaty, 24 Phila. 73 (1992) a Pennsylvania Common Pleas Court chided an insurer for failing to intervene or take appropriate action to obtain reimbursement for its subrogation claim.

must convince an opposing claims adjuster, lawyer, or jury that the damages paid under the policy were actually sustained, not inflated, reasonable, and recoverable under the tort or contract law of the jurisdiction (which will differ from the policy).

The second step is to document the damage claim. Preserving as evidence not only the things that may have caused the fire, but also proof of damaged items, is important. Keeping some actual physical samples of damaged items, numerous photographs, and extensive backup documentation is essential. For example, for damaged business or personal property, determining original cost and date of acquisition for larger, expensive items is always advisable. Detailed inventory lists taken room by room, while a pain to obtain, are unbelievably helpful. Having the insured provide original costs, estimated values, and dates of acquisition shortly after the loss, while memories are fresher, is very helpful. Also, an independent assessment by the adjuster of the actual cash value and replacement cost can help immeasurably later on.

The third step is sifting through the documents after the claim has been documented and paid. This stage is where the recovery personnel or counsel take a hard look at 1) what has been paid under the policy and 2) what is recoverable in the jurisdiction whose damage law will apply. The key point to remember is that the two figures are not identical. For example, in real property cases, the law of most jurisdictions only allows recovery of the diminution in market value while insurance policies generally pay either replacement cost, i.e., what it would cost to rebuild the building with like materials; or actual cash value which essentially is what it cost to put up the structure when it was put up. As an illustration, a magnificent old stone home in a depressed neighborhood or an old factory in a depressed industrial park present classic problems. If insured at replacement cost and actually repaired or replaced following a devastating fire, the

losses at replacement cost can easily be in the millions of dollars. The diminution in market value of those same structures may only be in the hundreds of thousands of dollars.

The sifting process should include the recognition of issues such as the one set out above and creative but legitimate arguments in an effort to maximize damages. Several examples involve arguing that a particular structure is unique and therefore replacement cost rather than market value should be the measure of damage [Trinity Church v. John Hancock Mutual Life Ins. Co., 502 N.E.2d 532 (Mass. 1987)]; mandatory code upgrades should be included even though not in the original structure because defendant's actions resulted in the increased cost [Peluso v. Singer General Precision, Inc., 365 N.E.2d 390 (Ill. App. 1977)]; household items should be valued at replacement cost rather than market value because they have unique value to the owner and what they would bring in a garage sale is not a true measure of the loss to the plaintiff [Lynch v. Bridges & Co., Inc., 678 A.2d 414 (Pa. Super. 1996)]. Not all of these arguments will work, but the process must be undertaken to identify potential problems and advance sound arguments for recovering the amount paid if at all possible.

Carefully and promptly sifting through the damages to make sure the insurance adjustment figures have been converted to those recoverable under the law will enable you to start the negotiation process at the best figure possible and help you resist arguments that your damages are inflated or unreasonable. Ideally, statements of loss, subrogation and/or loan receipts, and proofs of loss are critical documents that should be obtained to prove damages in every case.