COZEN AND O'CONNOR
REGIONAL SUBROGATION PRACTICE UPDATE LAW AND PROCEDURE
CONNECTICUT AND NEW YORK

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I. SPOLIATION OF EVIDENCE

Spoliation is defined as the destruction of material evidence. Spoliation arises when evidence is lost, altered, or destroyed during testing. In fire loss cases, spoliation may be alleged when a party to a lawsuit fails to preserve or intentionally destroys fire artifacts. Sanctions for destruction of evidence vary, but typically may include: an adverse inference jury instruction at trial; preclusion of evidence or expert testimony; or outright dismissal of a claim. Increasingly, many jurisdictions also recognize an independent cause of action in tort to remedy damages resulting from spoliation.

A. Connecticut

Connecticut does not recognize a cause of action for spoliation of evidence. Fontanella v. Liberty Mut. Ins. Co., 1998 WL 568728 (Conn. Super. Aug. 26, 1998) (refusing to recognize negligent spoliation as a new tort).

The Connecticut Supreme Court has stated that "the trier of fact may draw an inference from the intentional spoliation of evidence that the destroyed evidence would have been unfavorable to the party that destroyed it." Beers v. Bayliner Marine Corp., 236 Conn. 769, 775, 675 A.2d 829 (1996). To warrant an adverse inference, spoliation must be intentional, the destroyed evidence must be relevant, and the non-spoliating party must have acted with due diligence. In Beers v. Bayliner, the Supreme Court of Connecticut reversed the trial court's grant of summary judgment because plaintiff had not intentionally destroyed the evidence and defendant was not severely prejudiced by the spoliation. See also Moisei v. Pilkington Barnes-Hind, Inc., 1997 WL 539784 (Conn. Super. Aug. 21, 1997) (refusing to allow adverse inference for negligent spoliation).

B. New York

Spoliation of evidence is not recognized as a separate tort under New York law, although in certain instances a party may sue a spoliator for impairment of the ability to sue a tortfeasor. Tiano v. Jacobs, 2001 WL 225037 (S.D.N.Y. Mar. 6, 2001) (action may be maintained where employer impairs employee's right to sue a third-party).

New York law provides various methods of sanctioning a party who conceals or destroys material evidence, including striking the spoliator's pleading or entering default judgment against a spoliator. In New York Cent. Mut. Fire Ins. Co. v. Turnerson's Electric, Inc., 721 N.Y.S.2d 92 (2d Dept. 2001), the court upheld summary judgment dismissal of negligence claims brought by a subrogated fire insurer as a result of destruction of an electric circuit panel box. The insured's home was so extensively damaged that local fire officials were unable to determine the cause of the fire. The insurer hired a private investigator, who concluded the fire was electrical in nature. The investigator removed an electric circuit panel box from the fire scene to further examine it, but later was instructed by a claims adjuster employed by the insurer to destroy the box. Based on the investigator's opinion that the fire was electrical in origin, the insurer filed suit against the defendants contending they negligently performed electrical work in the house. The defendants sought summary judgment based on spoliation of the circuit panel box. The court concluded the defendants had been prejudiced by the destruction of this key item of physical evidence. Dismissal of the complaint was an appropriate remedy, even if the evidence had been destroyed before the spoliator became a party, provided the spoliator was on notice that the evidence might be needed for future litigation. See also Cummings v. Central Tractor Farm & Country, Inc., 722 N.Y.S.2d 285 (3d Dept. 2001). (Defendant's negligent destruction of a crucial piece of evidence before plaintiff's and co-defendant's experts had opportunity to examine it resulted in the defendant's answer being stricken).

In Hartford Fire Ins. Co. v. Regenerative Bldg. Constr., Inc., 271 A.D.2d 862, 706 N.Y.S.2d 236 (3d Dept. 2000) a property insurer filed a subrogation action arising out of the freezing of water pipes in a home and subsequent release of steam and water, which caused significant property damage. The insurer alleged the loss was due to negligent design and installation of the heating system. The defendant general contractor filed a motion for summary judgment seeking to dismiss the complaint based on the insurer's alleged spoliation of evidence, including the ruptured water line and valve leading to the basement sink and water line leading to the washing machine. The court denied the defendant's motion for summary judgment, noting the evidence had been disposed of years before the subrogation action was instituted, and also that the defendant failed to show it had been prejudiced by the inability to examine the pipes. See also Longo v. Armor Elevator Co., 278 A.D.2d 127, 720 N.Y.S.2d 443 (1st Dept. 2000) (Spoliation sanctions were not warranted, despite defendant's having discarded elevator parts, where the missing evidence did not prevent plaintiff from pursuing causes of action).

C. Federal Cases

Spoliation may result in an instruction to the jury that it may draw an inference that the evidence would have been unfavorable to the destroyer under the Federal Rules of Civil Procedure and Federal Rules of Evidence. More severe sanctions are available, including dismissal of a claim or defense. Federal courts within the Second Circuit Court have imposed spoliation sanctions when the party in possession of material evidence had an obligation to preserve the evidence at the time it was destroyed. An obligation to preserve evidence usually arises when a party has notice that the evidence is relevant to pending litigation, or when a party should know that the evidence may be relevant to future litigation.

Within the Second Circuit, the law is unclear regarding precisely what state of mind a party must have when engaging in destruction of evidence. In some cases courts have

required intentional destruction of evidence or bad faith, but in other cases courts have given an adverse inference instruction based on gross negligence. See, e.g., Reynoso v. Harrison, 205 F.3d 1324 (2d Cir. Mar. 6, 2000) (unpublished opinion).

In Byrnie v. Town of Cromwell Bd. of Educ., 243 F.3d 93 (2d Cir. 2001), the court upheld an adverse inference against the defendant school system based upon the school's destruction of records and other materials relevant to a hiring discrimination case. The court found that the records had been destroyed in violation of a records retention regulation, and with a culpable state of mind, and that they were relevant to the plaintiff's claim.

In other recent federal decisions, courts declined to impose spoliation sanctions. In Fujitsu Ltd. v. Federal Exp. Corp., 2001 WL 403012 (2d Cir. Apr. 20, 2001), the plaintiff sued the defendant cargo carrier for damage to a container of silicon wafers while in the carrier's possession. The plaintiff had informed the carrier of damage to the container immediately upon its arrival, but plaintiff destroyed the container and the wafers on instructions from its insurance company. The cargo carrier never contacted plaintiff to seek an opportunity to inspect the container or otherwise request that the container or wafers should be retained. Nevertheless, the carrier sought a sanction against the plaintiff for spoliation based on destruction of the wafers. The trial court decided that the carrier had failed to demonstrate that plaintiff intentionally destroyed the evidence. Moreover, because the carrier did not request to inspect the damaged shipping container at any time prior to making its summary judgment motion, sanctions for spoliation were not warranted.

D. Insurer Liability for Spoliation

Increasingly, insurers may face liability to policyholders for spoliation of evidence relating to uninsured losses, either in the form of a tort action or potential bad faith liability. Liability may arise out of possession, alteration, destruction, or testing of evidence by

insurers or their representatives, if this activity damages or impairs the policyholder's claim. Courts in Connecticut and New York have not expressly examined the issue of insurer liability for spoliation, although courts in other jurisdictions have imposed liability on insurers for such spoliating conduct.

For example, Cooper v. State Farm Fire & Cas. Co., No. 93 L 3898 (Ill. Cir. Ct., Cook Cty. Jan. 19, 1999) involved an action for spoliation of evidence filed by the son of a building tenant who was seriously burned in an apartment fire against the building insurer. The insurer identified a gas range as the cause of fire, but failed to preserve the range, which subsequently was destroyed. The case resulted in the payment of a settlement by the insurer to the plaintiff. See also Smith v. Atkinson, 771 So.2d 429 (Ala. 2000) (allowing claim against insurance carrier for negligent spoliation of minivan involved in fatal accident; insurer's alleged spoliation precluded survivor's products liability claim against minivan manufacturer); Thompson v. Owensby, 704 N.E.2d 134 (Ind. App. 1998) (upholding a claim filed by dog-bite victims against the dog owner's liability insurer for breach of the duty to preserve a dog-restraining cable which was in the insurer's possession during investigation).

In other cases insurers may be liable for bad faith arising from spoliation. See Weiss v. United Fire & Cas. Co., 197 Wis. 2d 365, 541 N.W.2d 753 (1995) (policyholder suit against homeowner's insurer for bad faith failure to investigate); Upthegrove Hardware, Inc. v. Pennsylvania Lumbermans Mut. Ins. Co., 146 Wis. 2d 470, 431 N.W. 2d 689 (Wis. App. 1988) (affirming a jury verdict of bad faith and punitive damages in favor of the insured against a business insurer for intentional spoliation, based on the fact that the insurer's investigator discovered a lamp and cord that the insured believed caused the fire, lied about the condition of the cord, and discarded it).

II. ECONOMIC LOSS DOCTRINE

The economic loss doctrine is a judicially-created rule precluding tort recovery for economic damages arising out of a product's failure to perform, in the absence of physical injury or property damage. Most courts have adopted some version of this rule, although exceptions exist. Some courts also extend applicability of the economic loss rule to non-products tort cases.

A. Connecticut

The economic loss rule is not uniformly applied in Connecticut. In Reynolds, Pearson & Co., LLC v. Miglietta, 2001 WL 418574 (Conn. Super. Mar. 27, 2001), the court recently explained:

> There is inconsistency in the decisions of Superior Court judges regarding the applicability of the economic loss doctrine in Connecticut. One line of authority holds that the economic loss doctrine has been accepted and applied by Connecticut courts …. In contrast, the other line of authority rejects the proposition that the economic loss doctrine has been adopted by the appellate courts and allows tort claims despite the fact that only economic losses are claimed.

Id. at *4 (citations omitted). Under Connecticut law, the economic loss doctrine is inapplicable to intentional torts and misrepresentation claims. See id.

In RCD-Hudson, LLC v. T.A.T. Mason Enterprises, Inc., 2001 WL 103986 (Conn. Super. Jan. 17, 2001), the court held the economic loss rule did not prevent an action by a general contractor against a subcontractor who negligently performed masonry work, although the damages alleged were economic in nature, i.e. costs to correct the faulty work.

But in Amity Regional School Dist. No. 5 v. Atlas Constr. Co., 2000 WL 1161095 (Conn. Super. July. 26, 2000), the court rejected the plaintiff's contention that the economic loss doctrine was not recognized under Connecticut jurisprudence. The court held, "The economic loss rule has been applied in other jurisdictions to bar contractor tort claims

against design professionals for economic loss." Id. at * 2. The court concluded that a claim for loss of use was not a property damage claim that would avoid the application of the economic loss rule, but rather is a commercial, contractual-type of loss. See also Amity Regional School Dist. No. 5 v. Atlas Constr. Co., 2000 WL 1198163 at *3 (Conn. Super. Aug. 4, 2000), ("The Connecticut Supreme Court has expressed its intent to respect the agreements of business persons who later claim commercial losses arising out of defective performance of contracts, by barring recovery in negligence for economic loss.")

B. New York

New York courts generally adhere to the economic loss rule, holding that purely economic losses without property damage or personal injury are not recoverable in a negligence action. A claimant suffering purely financial loss is restricted to an action in contract to recover the lost benefit of the bargain. See 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Center, Inc., 271 A.2d 49, 711 N.Y.S.2d 391 (1st Dept.), leave to appeal granted, 276 A.D.2d 1016, 718 N.Y.S.2d 813 (1st Dept. 2000). Exceptions exist to this rule, including situations where there has been some minor damage to property or personal injury.

In 532 Madison Ave. v. Finlandia, the plaintiff brought negligence and public nuisance claims against the owners and manager of a nearby skyscraper after the wall of the skyscraper collapsed during renovation, forcing the store to close for five weeks. The court held that the plaintiff could seek recovery of economic damages on its negligence claim, despite the absence of incidental property damage, based on the defendant's knowledge and reckless disregard of the risks involved in renovation to the skyscraper. The defendant should have anticipated that pre-existing structural problems would negatively affect the planned renovation and could foreseeably result in injury to others. The fact that the injuries were not catastrophic to persons passing by this area was purely fortuitous. Therefore, to permit a negligence action to

proceed properly allocated the risk of loss and the costs of engaging in dangerous activities. See also Hydro Investors, Inc. v. Trafalgar Power, Inc., 227 F.3d 8 (2d Cir. 2000) (economic loss rule did not preclude recovery of damages arising out of professional engineering services).

III. EXCULPATORY, HOLD HARMLESS, AND INDEMNITY AGREEMENTS

Lease, bailment, alarm contracts, and construction agreements often contain standard exculpatory or hold harmless clauses. Liquidated damages provisions, restricting recovery in the event of loss to a specified amount, also may be an issue in subrogation cases. These contractual provisions, protecting a party from the consequences of his or her own negligence, generally are enforceable, with certain exceptions, for example where a party is grossly negligent. State statutes may affect enforceability of exculpatory agreements, particularly in the areas of lease and construction contracts.

A. Connecticut

Exculpatory contracts, though disfavored, are not automatically void and unenforceable under Connecticut law, although the policy is for courts to closely examine the particular agreement in question. To be valid, there should be specific and conspicuous reference to negligence. See Malin v. Whitewater Mt. Resorts of Conn., Inc., 2001 WL 309030 (Conn. Super. Mar. 16, 2001), (exculpatory contracts consisting of preprinted forms used by professional service providers in the course of dealing with the general public receive careful judicial scrutiny). This rule is relaxed in a purely commercial setting, where parties typically bargain as to the risk of damage and set the price accordingly. See Messore v. Carbetta, 28 Conn. L. Rptr. 80, 2000 WL 1228035 (Conn. Super. Aug. 21, 2000). Any ambiguity in an agreement to hold harmless or indemnify is resolved against the drafter.

In Guild v. Exxon Corp., 81 F. Supp. 2d 377 (D. Conn. 1999), the court granted summary judgment to the defendant based on a hold harmless provision contained in an

agreement to purchase a gas station which later was found to be contaminated. The court held the hold harmless clause was valid because the underlying claim alleged breach of contract rather than negligence.

In Goldstein v. Mitoi, Inc., 26 Conn. L. Rep. 187, 2000 WL 125052 (Conn. Super. 2000), in ruling on the enforceability of a liquidated damage clause contained in an alarm system lease and service contract, the court denied summary judgment. A liquidated damages clause is enforceable if: the damage resulting from breach of contract is uncertain or difficult to prove; the parties intended to liquidate damages in advance; and the amount stipulated was reasonable. In this case, fact issues were raised as to the reasonableness of the liquidated amount. But see Fitzpatrick v. DeMontigny, 2001 WL 51673 (Conn. Super. Jan. 2, 2001) (upholding liquidated damages provision); Hartford Ins. Co. v. ADT Sec. Systems, Inc., 1999 WL 259688 (Conn. Super. Apr. 22, 1999) (upholding liquidated damages provision in alarm service contract, except where defendant acts fraudulently or in bad faith).

B. New York

Port Authority of New York and New Jersey v. Evergreen Intern. Aviation, Inc., 275 A.D.2d 358, 712 N.Y.S.2d 587 (2d Dept. 2000), involved enforceability of a commercial lease provision. Lessee Evergreen entered into a lease with Port Authority for space at JFK Airport. The lease contained an indemnification clause requiring Evergreen to hold Port Authority harmless from liability for all claims and demands of third persons, and obtain comprehensive insurance naming Port Authority as an additional insured. A sprinkler valve in the leased premises ruptured, flooding Evergreen's property. Evergreen's property insurer compensated Evergreen for its loss, and subsequently brought a subrogation action in federal court against Port Authority alleging negligence. Port Authority filed an action seeking a declaration that Evergreen had a duty to insure, defend, indemnify, and hold it harmless in the

federal action. Evergreen sought summary judgment on grounds that Port Authority was not entitled to indemnification in the underlying federal action.

Under New York law, a lease provision which purports to exempt a lessor from liability for its own acts of negligence is void and unenforceable. Although lease provisions in which the parties allocate the risk of liability to third parties between themselves through the use of insurance are generally enforceable, a landlord may not circumvent the statute simply by placing the burden to procure insurance on the tenant. The lease agreement in this case placed the sole obligation to obtain insurance upon Evergreen, but it lacked language demonstrating a mutuality of intent to exculpate the landlord from negligence toward its tenant. The court decided that the insurance procurement clause contained in the lease was unenforceable, because it purported to relieve the Port Authority of responsibility for damages caused to Evergreen as a result of the Port Authority's own negligence.

In Metropolitan Prop. & Cas. Ins. Co. v. Budd Morgan Cent. Station Alarm Co., Inc., 95 F.Supp. 2d 118 (E.D.N.Y. 2000), a subrogation action, a homeowner's insurer sued a home security monitoring company to recover for property damages sustained in a fire. The home security system contract contained an exculpatory clause, which the court held was not unconscionable under New York law, but would not relieve the monitoring company from liability for grossly negligent conduct. The court decided the subrogation action raised genuine issues of material fact sufficient to preclude summary judgment regarding whether the monitoring company had been grossly negligent in carrying out its central station monitoring.

IV. WAIVER OF SUBROGATION PROVISIONS

In a subrogation action, the insurer is subject to the same defenses (such as hold harmless or exculpatory agreements) applicable to the insured. Often, the parties to an underlying agreement also waive certain rights to sue each other or agree that insurance will

cover any loss occurring. Thus, a common defense to subrogation actions is express or implied waiver of subrogation clauses.

A. Connecticut

In Maryland Cas. Co. v. Trane Co., 46 Conn. Supp. 172, 742 A.2d 444 (1999), the court held that a general contractor's waiver of subrogation rights against a contractor precluded a subrogation action by a liability insurer to recover costs paid to repair/replace defective fan coil units installed at a construction site. The construction contract specified that contractor and subcontractor waived "all rights they may have against one another for damages covered by property insurance, workers compensation, commercial general liability and automobile insurance." The language of this waiver was clear, unambiguous, and expressed the parties' intent to waive subrogation rights. The insurer was bound by the waiver as well, although the policy prohibited waiver of subrogation rights by the insured thus giving rise to a cause of action by the insurer against the insured for breach of the policy condition.

B. New York

In Travelers Indem. Co. of Conn. v. Losco Group, Inc., 2001 WL 336947 (S.D.N.Y. Mar. 23, 2001), a property insurer for a school brought a subrogation action against contractors to recover damages arising out of the collapse of the school's gymnasium roof. The subrogation action alleged gross negligence and breach of contract. The court held the construction contract, which provided that the school and contractors waived all rights against each other for damages but only to the extent covered by property insurance during construction, precluded the breach of contract claim. Alternatively, the contractors could not escape liability through a contractual waiver clause for damages caused by gross negligence. "While waiver clauses in commercial contracts are enforceable to limit recovery for claims based on ordinary negligence, they will not preclude recovery in tort or breach of contract where the losses are the

result of gross negligence." The plaintiff stated a claim for gross negligence by alleging the contractors had improperly erected, tested, and inspected steel trusses and welds.

In Continental Ins. Co. v. West 29th Street Owners Corp., 274 A.D.2d 604, 713 N.Y.S.2d 38 (1st Dept. 2000), a property insurer sued the insured's landlord for property damage and business interruption losses resulting from a sprinkler system activation due to a fire alarm malfunction. The lease contained the following waiver of subrogation:

> In the event that Lessee suffers loss or damage for which Lessor would be liable and Lessee carries insurance which covers such loss or damage and such insurance policy or policies contain a waiver of subrogation against the Landlord, then in such event Lessee releases Lessor from any liability with respect to such loss or damage.

The policy obtained by the lessee did not contain a waiver of subrogation, but merely permitted the insured to waive its rights in writing prior to a loss. Thus, because the policy did not actually implement a waiver of subrogation, the waiver provision contained in the lease was ineffective.

In Loctite VSI Inc. v. Chemfab New York, Inc., 268 A.D. 2d 869, 701 N.Y.S. 2d 723 (3d Dept. 2000), the court held that a commercial lease agreement requiring the landlord to maintain a standard fire and extended coverage insurance policy and obtain a waiver of subrogation from its insurer precluded the landlord from recovering damages from the tenant even if the fire had been negligently caused by the tenant or its agents.