OVERVIEW OF SUBROGATION AND RECOVERY ISSUES

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I. INVESTIGATION TECHNIQUES

It is not possible to devise a comprehensive checklist that spells out the activities or procedures that should or must be performed in investigating each and every fire, building collapse or other property loss investigation. Experience and common sense suggest certain procedures that are generally desirable to follow in the investigation of any casualty, as well as procedures specifically applicable to various kinds of property losses, including fires, collapses, freeze-ups, storm damage, etc. For example, in the field of fire investigation, the National Fire Protection Association ("NFPA") has issued and periodically revises a collection of "guidelines" for fire investigators. The most current version of the NFPA's fire investigation guidelines is the 1998 Edition of NFPA 921, "Guide for Fire and Explosion Investigations".

However, the appropriate procedure to follow in any particular situation will vary depending upon the specific circumstances of a loss, including the severity of the loss in terms of the extent of the property damage suffered by the insured and others as well as any associated personal injuries or deaths, the number of potentially interested parties known to be involved at the outset or who are identified as the investigation progresses, the potential for an ongoing criminal or other parallel governmental investigation, the extent of any environmental or other safety hazards at the site, both to the investigators and to the public, the urgency of commencing site restoration activities, and countless other factors. Even NFPA 921 recognizes the flexibility an investigator must employ in conducting a fire investigation, which probably helps to explain why the most recent version of the guidelines occupies over 160 pages of dense, two-column text.

Because there is no "one size fits all" investigative checklist that applies to all cases, those who investigate or supervise the investigation of property losses must rely heavily upon their common sense and experience. However, it is not possible to be sure that an adequate and complete investigation is being performed, unless you are able to:

A. Recognize all potential liability theories;

B. Select the right kinds of experts and use them appropriately; and

C. Recognize what evidence needs to be preserved and how it should be preserved.

The legal concepts that are pertinent to each of these three major considerations are constantly evolving. Accompanying this outline is a collection of articles which discuss at length many of the most important legal and practical issues to consider. What follows is a brief discussion of some of the highlights that can be gleaned from these articles.

A. Recognizing Potential Liability Theories (Especially the Less Obvious Theories)

Logically, anybody who has an interest in investigating a property loss would want to determine what the relevant facts are first, and then decide, based on those facts, where potential liability for the loss may lie. However, it is not possible to know what facts are "relevant," or whether all of the relevant facts are at hand, unless there is an appreciation of all of the potentially applicable liability theories. If the personnel responsible for directing the investigation are not tuned in to all potential liability theories, important evidence and many potential opportunities may be lost forever at the early investigation stage. Opportunities can also be irretrievably lost early in the game as a result of imprudent decisions regarding the selection and use of experts.

The attached articles discuss many of the less obvious liability theories that often present themselves in the context of property losses. Unfortunately, these theories often go unrecognized, at least until it is too late to act on them. If there is one concept that anyone faced with evaluating recovery prospects in any property loss situation should keep in mind, it is the concept of "multiple proximate causes" or "concurrent causation".

Obviously, if conduct did not "proximately cause" a loss, there can be no legal liability for that loss. With minor variations, "proximate cause" is defined in most jurisdictions as either a "but for" cause, or as a "substantial contributing factor" to the occurrence of a loss.

All jurisdictions recognize that there can be more than one proximate cause of a loss. While common sense suggests that there usually is more than one factor that contributed to the occurrence of a property loss, the implications of the concept of multiple proximate causes are often not fully appreciated. Here are some examples:

1. There may be subrogation opportunities in a fire loss even when the cause of the fire cannot be identified, or when no financially viable third party bears responsibility for the known cause of a fire, or even where the insured was at fault for actually starting the fire:

   (a) There may have been a delay in detection or discovery of a fire because of defects or inadequacies in a fire alarm or suppression system. However, it will likely be impossible to evaluate such a theory if a qualified expert does not have an opportunity to inspect the relevant systems and equipment while they are still in place and undisturbed, and to fully evaluate the manner in which the fire developed;

(b) An improperly designed or maintained fire suppression system may fail to extinguish or control an otherwise controllable fire. Any severe fire that occurs in a sprinklered structure or in an installation equipped with an automatic fire suppression system is a situation calling for further inquiry. Again, the identification of potential subrogation opportunities in such situations normally requires prompt, on-scene investigation by qualified experts;

(c) In an exposure loss situation, where an insured suffers fire, smoke or water damage from a fire that originated in a neighboring occupancy, the fire may have spread faster or further than it should have due to building code violations or other deficiencies in the building's construction on materials, or because of unsafe storage practices or poor housekeeping in the area where the fire started. Also, the occupant of the area of origin may bear responsibility for a fire that grew out of control because personnel delayed notifying the fire department while they tried to fight the fire.

2. It's not nice to sue Mother Nature, and you couldn't do it even if you wanted to. However, that does not mean that any possibility of pursuing subrogation should be abandoned in so-called "Act of God" losses. For example, in the case of a roof collapse due to excessive snow loading, consider whether the accumulated weight of the snow exceeded minimum design standards. In many cases, applicable building codes require reinforcement of those portions of a roof's supporting structure where drifting can be expected to occur. This code analysis depends upon the configuration and orientation of each particular roof, and can

only be evaluated on a building-by-building basis. Also consider whether the roof as designed would have collapsed even under a significantly lighter snow load. The fact that the roof collapsed on the insured's building, but not on the buildings on either side of it or across the street, is a signal that some further inquiry is appropriate.

The snow loading cases are an excellent illustration of the importance of early investigation, because the opportunity to document critical conditions will be lost in such cases, unless there is immediate action. Accumulated snow depth, particularly drifting, varies so much from building to building that National Weather Service records are generally no substitute for actual, on-site measurements of snow depth. Also, building codes and building design criteria are based upon the weight of snow loading and not snow depth, because there is an infinite range of snow weights and densities. Therefore, in addition to measuring the snow's depth, it is also necessary to measure its weight per square foot. Thus, as quickly as it takes for snow to melt, crucial evidence can disappear forever.

Finally, to confirm the specific failure mode, a qualified engineer should inspect the failed building components before the collapsed structure is disturbed. This will also confirm whether the structure as built conformed to the contract plans and specifications.

Roof collapses due to snow loading are not the only situations where subrogation opportunities may be lurking beneath an apparent "Act of God":

(a) Where high winds cause damage to roofing materials or other portions of a building, consider whether neighboring structures suffered similar damage. If not, the loss site may have had deficiencies in building design or construction that rendered it incapable of meeting minimum code requirements. It is also

important to determine the actual wind speeds at the loss site. Again, National Weather Service data, while convenient and generally available, is of limited use because wind speeds can vary dramatically over relatively short distances from the reporting stations. Modern meteorologists draw upon satellite information and other data to identify weather conditions at a particular location with amazing precision. Once again, however, the weather data may be useless if a qualified expert has not had the opportunity to thoroughly examine the loss site and identify and document the failure mode before the site is disturbed;

(b) In a flooding case, the adequacy of the design of the stormwater drainage system should be considered;

(c) In the case of plumbing freeze-ups, something usually went wrong somewhere and it is often somebody else's fault. The furnace may have malfunctioned or the heat may have been turned down or a window left open that should not have been, a pipe may not have been adequately insulated, heat-taped or otherwise protected from the elements or an unprotected pipe may have been inadvertently left filled with water.

In any case involving a pipe failure or leak, it is important not only to secure the failed pipes or fittings, but also to document where each was found on site, and to get the failed items into the hands of a qualified expert before corrosion significantly alters their post-loss

condition. If possible, the expert should inspect the site before repairs are performed and the specific location in the system of each leak should be documented.

Sensitivity to recovery opportunities like these has resulted in recovery even in "Cat Loss" situations. However, the examples discussed above illustrate that the evidence required in order to evaluate and pursue such claims must be secured and documented promptly after the loss and there is usually only a very limited time in which to do so, perhaps no longer than it takes the snow to melt following an unexpected spring blizzard. At the same time, in any major natural catastrophe, claims personnel typically have their hands full in attempting to meet the urgent needs of numerous policyholders. It is on such occasions that professionals dedicated to protecting the insurance company's subrogation interests can be of greatest assistance to the company, if they are notified and become involved immediately after the loss.

B. Selection and Usage of Experts

1. Kinds of Experts

Common sense will normally dictate which kinds of experts are appropriate for which kinds of cases. The key issue is to be sure that the need for the right kind of expert is identified early enough for the expert to be of maximum assistance.

Steer clear of "generalists" who claim to be experts in everything. The very fact such witnesses spread themselves so thin renders them vulnerable to impeachment. Some so-called experts think that resumes listing dozens of areas of supposed expertise make them look good. However, they are only creating ammunition for opposing counsel to use against them in cross-examination. There is also a much greater likelihood that such a "jack of all trades" will overlook something important during the investigation that a more focused expert would not have missed.

Equally dangerous is an expert who truly has strong credentials in a particular field, but who does not recognize the limits of his or her own expertise, and wants to "do it all for you." For example, most fire cases will require the services of a qualified cause and origin investigator, and it is common to rely exclusively upon such investigators to conduct the preliminary investigation. It is at this preliminary investigative stage that the need for other experts should be identified. However, it may take some probing questioning of the investigator to reveal whether additional consultants in other fields will be needed in order to perform a complete analysis of the situation that will hold up in court. This is true even when the potential cause identified by the investigator does not seem to involve any other scientific disciplines. The determination of a fire's cause normally requires the elimination of alternative causes, and the potential alternative causes that must be eliminated may implicate matters beyond the cause and origin investigator's expertise.

Also beware of entrusting all aspects of an investigation to "full service" forensic consulting firms. Such firms often have qualified personnel on staff, but that does not mean that every expert that the firm employs in every pertinent field is the particular expert you want to work on that particular case. The benefits of individually selecting the most appropriate experts in each field often outweigh any supposed "efficiency" in using multiple experts from the same firm. Also, one of the benefits of working with multiple experts from multiple disciplines is that the experts can identify weak points in each other's analysis, which should strengthen the overall case. Multiple experts employed by the same firm may feel the need to put up a united front, and therefore may be less inclined to challenge one another's conclusions.

2. Licensing Issues

The attached article entitled "The Impact of Professional Licensure Requirements Upon a Fire Investigator's Qualification to Testify as an Expert" thoroughly discusses the question whether and when an expert is required to hold a private investigator's or professional engineer's or other license in order to be permitted to testify at trial. While this is a potential problem in many states, it is most definitely a problem in Illinois and Ohio, where there are already reported decisions on point, excluding testimony from unlicensed experts. See, e.g., People v. West, 264 Ill. App. 3d 176, 636 N.E. 2d 1239 (5th Dist. 1994) appeal denied 157 Ill. 2d 519, 642 N.E. 2d 1300 (1994). It is important to recognize and be sensitive to this issue at the very outset of the investigation, at the time the experts are originally hired. Otherwise, you may learn that you entrusted the site investigation, or other critical activities, to an expert who would never be allowed to testify in a particular jurisdiction, and it may then be too late to undo the damage.

3. "Daubert" Issues

An investigation conducted by a licensed and otherwise qualified and carefully selected expert is worthless if the expert will not be allowed to testify at trial. There is no reason to go to the expense of conducting an investigation with the assistance of experts if there is no hope of eventually winning the case at trial, and there usually will be no chance of winning a case, or even having a jury decide the case, if your experts are not even allowed to take the stand. The decision whether or not an expert will be allowed to testify now quite often hinges upon how trial judges interpret the 1993 decision of the United States Supreme Court in Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).

In the Daubert decision, the Supreme Court tried to reconcile what are often valid concerns over the use of "junk science" in court, particularly in toxic tort cases, with the rather vague and seemingly liberal language of the Congressionally enacted Federal Rules of Evidence relating to the standards for admission of expert testimony. A more detailed discussion of the Daubert decision appears in the attached article on "Avoiding Six Phantom Roadblocks to Subrogation." In broad terms, the Daubert decision basically abandoned a standard for admission of expert testimony that required the expert's opinion to be based upon "generally accepted" scientific principles, in favor of a supposedly more flexible standard. However, the greater flexibility has given federal trial judges greater leeway to exclude expert testimony that the judges feel lacks an adequate basis and, once the expert's opinions are thrown out of court, the case upon which those opinions is based is normally thrown out with it.

The U.S. Supreme Court's most recent decision on the subject in General Electric v. Joiner, 118 S.Ct. 512 (1998), only served to confirm the broad discretion that federal district judges have to admit or exclude expert testimony based upon the judge's own assessment of the adequacy of the basis for the expert's conclusions. Technically, Daubert and Joiner are controlling only in federal courts. However, the cases are influential in state courts, as well.

Litigation-savvy experts who do not relish the prospect of being "Daubertized" and having a judge exclude their opinions as baseless now recognize that they must amass so-called "Daubert material," consisting of published literature in their field independently supporting their methodology and analysis. While it is ultimately the lawyer's responsibility to develop expert testimony that will not simply be deemed adequate to be heard in court, but that will actually persuade a judge or jury to find in the client's favor, avoiding Daubert problems is not solely the lawyer's problem. Particularly in property loss cases, developing expert opinions

that have a sufficient basis to withstand an eventual Daubert challenge requires that necessary physical evidence is preserved and site conditions are properly documented, and that the post-loss investigation and evaluation of the evidence otherwise follows generally accepted methodology. If proper steps are not followed immediately after the loss, while the site is undisturbed and all evidence is available, with an eye toward compliance with Daubert standards, it may not be possible to correct the situation later.

4. NFPA 921

A major aspect of the evaluation of the admissibility of expert opinions endorsed in Daubert hinges upon whether the expert's methodology conforms to generally accepted practices in the expert's field. There is a cogent argument that fire investigation and matters involving electrical, structural and mechanical engineering, metallurgy, and similar "hard" sciences typically employed in the investigation of property losses do not present the concerns over "junk science" addressed in the Daubert opinion, and there is still an open question as to whether Daubert should apply at all to fire investigations. See e.g., Smith v. Ford Motor Company, 882 F. Supp. 770 (N.D. Ind. 1995). However, it is only prudent to assume that some courts will find that Daubert applies to such investigations. In the field of fire investigation, NFPA 921, "Guide for Fire and Explosion Investigations" is the closest thing to a compilation of "generally accepted" practices.

Perhaps more than other experts, fire investigators seem reluctant to recognize any publication as "authoritative" in their field. There is probably not one sentence in NFPA 921 that some qualified fire investigator somewhere would not disagree with. Nevertheless, the aura of independence associated with the NFPA and any NFPA publication makes NFPA 921 more authoritative than any other publication in the field. Therefore, any fire investigator should

attempt to comply with the provisions of NFPA 921, at least in the absence of a compelling reason for not complying. Such compliance reduces the risk of a successful Daubert-based challenge to the expert's methodology, and to the admission of the conclusions derived from that methodology. Additionally, an expert can anticipate relentless cross-examination on any deviations from NFPA 921. Finally, compliance with the provisions of NFPA 921 relating to the preservation and documentation of evidence should provide protection against an evidence spoliation claim.

Other, somewhat more obscure and industry-biased standards relevant to evidence preservation are ASTM E1188, the "Standard Practice for Collection and Preservation of Information and Physical Items by a Technical Investigator," and ASTM E680 "Practice for Examining and Testing Items That Are or May Become Involved in Products Liability Litigation." An expert's awareness of such standards may at least indicate that the expert has a minimal level of technical sophistication.

5. Reports

Consider carefully whether and when an expert should issue a written report, and for what purpose. Assuming that the expert is providing adequate oral updates either directly or through counsel, on the status of his or her investigation and analysis, the issuance of written reports before completion of formal discovery is particularly unnecessary and potentially dangerous. It is often only after the defendant has been forced to submit to formal discovery proceedings that you can be sure that there is an adequate factual background for an expert report. It is not that the facts will change, but there may simply not be adequate access to all relevant facts, particularly those known exclusively to the defendant, until after discovery has been conducted.

Once sufficient discovery has been completed, the federal courts and many state courts now require expert witnesses to issue a written report setting forth their conclusions and anticipated testimony. On rare occasions, after a financially viable subrogation target has been identified and the lines of communication have been established, the presentation of a report authored by a qualified expert may assist in bringing about a settlement. Apart from these situations, the premature issuance of an otherwise unnecessary expert report is much more likely to impede rather than assist in the resolution of a claim.

Courts generally take a liberal view regarding discoverability of expert's reports, particularly when such reports are contained in a property insurer's claim file. Addressing the reports to counsel can assist in protecting them from disclosure as non-discoverable "work product," but is no guarantee. Also, in most jurisdictions, any reports authored by an expert who is designated to testify at trial will eventually have to be produced. You should therefore assume that any written reports from an expert will eventually fall into the hands of an opposing party. A preliminary report based upon an incomplete or inaccurate understanding of the facts could needlessly inflect devastating damage to the expert's credibility and to the underlying case.

Similarly, a report which focuses exclusively on heaping responsibility upon a party who turns out to have no assets or insurance or who is protected by an ironclad subrogation waiver could needlessly hinder efforts to recover from defendants with deeper pockets. It may be preferable if such a report never gets written, and a new expert is hired to focus on more financially viable liability theories.

Thus, while it is understood that the experts must independently arrive at whatever conclusions they put in their reports, the decision as to whether or when to write the

report is the client's to make, and should be made with due regard for the strategic considerations outlined above.

B. Recognizing What Evidence Needs to be Preserved, and How to Preserve It.

1. Evidence Spoliation Issues

In the "good old days" of property loss investigation--10 or 15 or more years ago--an expert went to a scene, took pictures of whatever the expert deemed important enough to photograph, and saved whatever physical evidence the expert thought was important enough to save. The expert then blithely disassembled the suspected product or device, and conducted whatever destructive testing the expert thought was necessary to verify their theory. Eventually, usually long after the loss site had been rebuilt, the defendant was sued or placed on notice of a claim. The defendant would then retain an expert, and because the loss site was no longer available, the defense expert would have no choice but to use the plaintiff's expert's photographs and whatever physical evidence was available, and come up with a theory that contradicted the plaintiff's expert's theory. The defense expert and defense counsel might also challenge the adequacy of the plaintiff's expert's investigation and analysis, and challenge the adequacy of the evidence supporting the plaintiff's expert's theory. However, all of these issues were almost always left for the jury to sort out at trial.

In those "good old days," before spoliation fever swept through the courts of the land, both sides spent considerably less money on experts, and defendants probably won just about the same percentage of cases that they do now, because the emphasis on evidence preservation brought about by the expansion of the evidence spoliation doctrine means that plaintiffs are now accumulating the evidence required to more effectively and persuasively prove their cases.

In any case, the "good old days" are long gone. In the modern era of property subrogation litigation, defendants are pressing the courts for a supposedly more "level" playing field, so far as the gathering, documentation and preservation of evidence is concerned. The result is a legal minefield for subrogated insurers.

The evidence spoliation doctrine is expanding and developing at different rates and is taking shape in many different forms in the many jurisdictions that have considered it. Therefore, it is not possible to devise practical investigative procedures that are guaranteed to pass muster in all cases in all jurisdictions. Obviously, in a product liability case, it is absolutely critical that the remains of the product itself be preserved, ideally in the same condition that it was found immediately following the loss. In Sentry Ins. Co. v. Royal Ins. Co. , 196 Wis.2d 907, 539 N.W.2d 911 (1995), a house fire was alleged to have been caused by the malfunction of a refrigerator. While examining the refrigerator for purposes of identifying the cause of the fire, an expert for the homeowner's insurer removed critical components, without first notifying the refrigerator manufacturer. The manufacturer was later placed on notice, and provided with a copy of the expert's report which detailed his findings. Only after suit was filed many years later did the refrigerator manufacturer request to examine the refrigerator. By that time, the entire refrigerator had been discarded.

The refrigerator manufacturer moved for sanctions. The trial court concluded that because the defendant was precluded from conducting necessary testing on the refrigerator's electrical circuitry to determine the cause of the fire, a sanction was appropriate. The court then precluded introduction of any evidence of the condition of the refrigerator, which is a sanction tantamount to dismissal in a product liability case.

The court then granted summary judgment and dismissed the case.

The Wisconsin Supreme Court upheld the trial court's ruling, noting that "there is a duty on a party to preserve evidence essential to the claim being litigated". The court noted that, while the disposal of the refrigerator may have been inadvertent, the expert's removal of components from the refrigerator was plainly intentional, and this intentional conduct would have deprived the defendant of the opportunity to conduct necessary testing on the refrigerator, even if the refrigerator had been available. This reasoning suggests that the outcome of the case would have been the same even if the refrigerator had not been discarded. In the Wisconsin Supreme Court's view, the damage was done when the homeowner's insurer's expert partially dismantled the evidence.

Even when the product is preserved, that may not alone be sufficient. This was demonstrated by the decision of the U.S. Court of Appeals for the Seventh Circuit in Allstate v. Sunbeam, 53 F.3d 804 (7th Cir. 1995), a case involving Illinois law. In that case, an engineer investigating a house fire determined that the fire originated in the vicinity of a Sunbeam gas grill. The engineer and an Allstate adjuster decided that the only evidence that needed to be preserved from scene were the remains of the gas grill's fuel system, including the propane tank and the burner and everything in between. The expert and adjuster did not retain the grill's frame, and also failed to retain a spare propane tank that was located somewhere near the grill, but was not connected to or part of the grill assembly. After suit was filed, Sunbeam moved for sanctions. The trial court dismissed the case and the appellate court affirmed the dismissal, holding that Allstate's failure to preserve evidence that might have indicated that the fire was caused by something other than the grill, such as by a leak from the spare tank, irreparably prejudiced Sunbeam. The appellate court noted that "Allstate should have known that defendant would have wanted to examine the second tank". Thus, this case drives home the fact that, in

deciding what evidence to preserve, you should consider the point of view of a potential defendant.

The dismissal of a case, or complete exclusion of expert testimony, which is usually equivalent to dismissal, is normally based upon a trial court finding that no lesser sanction will remedy the prejudice to the defendant from the plaintiff's failure to preserve the evidence. While the appellate courts give the trial courts considerable discretion in such circumstances, the courts are expected to impose the least severe sanction that is appropriate under the circumstances. Bachmeier v. Wallwork Truck Centers, 507 N.W.2d 527 (N.D. 1993).

Thus, in Patton v. Newmar Corp., 520 N.W.2d 4 (Minn.App. 1994), a case involving a motorhome that caught fire, the trial court granted the motor home manufacturer's request to exclude the plaintiff's expert's testimony and to enter summary judgment, when the remains of the motor home had been inadvertently lost or destroyed. The Minnesota Court of Appeals reversed, holding that since the loss of the evidence was not intentional, complete preclusion of the plaintiff's expert's testimony was an unnecessarily severe sanction. Instead, the court excluded only that portion of the plaintiff's expert's opinions and testimony that was based upon examination of the motor home itself, as opposed to opinions based upon photographs of the motor home, which were equally available to the defendant. Thus, the prevailing attorney for the plaintiff/appellant in Patton "won" the opportunity to try the case with one hand tied behind his back. Moreover, it would be unwise to expect even this degree of lenient treatment from most courts in similar situations. Virtually any product liability defendant in such a situation can be expected to argue that the remedy fashioned by the Patton decision does not truly "level the playing field" or fairly remedy the prejudice to the defendant from disposal of the accused product, because the defendant is still deprived of the opportunity to

independently examine the product for evidence of alternative causes. As the Allstate v. Sunbeam case suggests, the same argument could logically (or, illogically, depending upon your perspective) be extended not only to other devices or appliances near the area of fire origin, such as the spare propane tank in the Sunbeam case, but also to the entire fire scene, since any defendant would assure you that they would prefer to independently examine burn patterns, fixed wiring, and other evidence on site in order to ascertain the "true" cause of a fire.

If the defendant's counsel can dream up anything that they would have liked to see for any minimally plausible reason (including all of the items that you are not blaming, for purposes of independently ruling them out), and you cannot produce the requested item, expect a motion for summary judgment or other sanctions based upon an evidence spoliation argument. Even if the court does not award the defendant the "grand prize" of an order dismissing the case, the judge may well give the jury an "adverse inference" instruction as a consolation prize for the defendant. Such an instruction informs the jury that they can infer that you were concealing something when you failed to preserve the item of evidence in question.

The best of all worlds is to let an adverse party come to the loss site before it has been disturbed, under your supervision, and put them under whatever time constraints are dictated by the circumstances. Then, the opposing party's representatives can photograph whatever they want to photograph, and if they want any artifact or sample preserved, it can be preserved, at least within reason. In that way, the defendant cannot later complain about something being unavailable, because they had the opportunity to ask for it and did not.

Therefore, regardless of whether the law requires you to do it or not, as soon as a potentially responsible party has been identified, they should be placed on notice and afforded some opportunity to visit the scene before proceeding with the next step in the investigation.

That will inevitably slow the investigation down and make it more expensive, especially because additional potentially responsible parties may continue to be identified as the investigation progresses. However, it is an excellent precaution against a spoliation claim.

Of course, the site of a fire or other property loss cannot be maintained in an undisturbed, museum-like setting forever. In the real world of property losses and insurance claims, the theoretically desirable goal of covering all possible bases as far as evidence spoliation issues are concerned is typically in conflict with and must take a back seat to practical concerns over the cost of preserving everything in its post-loss state, not to mention the normal and understandable concerns of the policyholder (and the insurer that has additional living expense or business interruption or other time element coverage) over commencing repair or reconstruction of the damaged home or business as soon as possible.

The good news is that most courts will be sympathetic to these real-world concerns, so long as some consideration has been given to the opposing parties' point of view. In particular, a court would probably not expect a policyholder to delay restoration efforts and to continue to incur time element losses in order to keep a loss site available for inspection, assuming that a diligent effort has been made to identify and notify potentially responsible parties and to afford them some opportunity to inspect the site while it is still available.

In short, courts would normally expect parties to do what is reasonable under the circumstances. The bad news is that what is reasonable under the circumstances will likely be gauged with the benefit of considerable hindsight, viewing events from the perspective of many months or even years after the loss. Also, courts tend to impose a somewhat more rigorous standard on subrogated insurers than on other plaintiffs, on the theory that insurers are more

sophisticated and should therefore have a better understanding of their evidence preservation obligations.

Also bear in mind that evidence spoliation concerns are not confined to the realm of subrogation cases, but can also adversely affect the insurance company's position with respect to coverage or bad faith issues. For example, in Upthegrove Hardware, Inc. v. Pennsylvania Lumbermen's Mutual Insurance Company, 146 Wis. 2d 470, 431 N.W.2d 689 (1988), the Wisconsin Court of Appeals upheld a jury verdict which found bad faith on the part of a property insurer and awarded punitive damages based upon the insurer's wrongful denial of a fire claim based upon an arson defense. The evidence supporting the jury's finding included testimony that the insurance company's cause and origin investigators had discovered a lamp and cord at the scene, which the insured had suggested might be the cause of the fire. The investigators took possession of the cord but, without further analyzing the cord or notifying the insured, discarded it as "junk". The investigators and the insured disagreed as to whether the cord was plugged in when they found it.

The court found that this evidence could support a conclusion that the investigators "intentionally discarded the cord because they knew it might have exonerated" the insured, and that they lied about whether or not the cord was plugged in. This was part of the evidence that was deemed sufficient for the jury's award of punitive damages. In a later bad faith case, Weiss v. United Fire and Casualty Company, 197 Wis. 2d 365, 541 N.W.2d 753 (1995) the plaintiff testified that the insurance company's cause and origin investigator, who was one of the same investigators involved in the Upthegrove case, had removed pieces of wire from the areas where the investigator claimed that the fire had originated, without ever analyzing the wires or informing the insurance company of their existence. The Wisconsin Supreme Court's

Opinion in Weiss noted that the insurance company's claims supervisor admitted that she had never verified the cause and origin investigator's qualifications, and that if she had done so, she might have found that in another fire investigation (referring to the Upthegrove case) the same investigator "had also failed to disclose that electrical evidence had been removed from the premises, and the investigator's conduct had triggered a punitive damages award against the insurer in that case".

No matter what precautions are taken against an evidence spoliation claim, you can expect that the defendant will claim that some further or additional steps should have been taken. If your expert retains a can opener that is believed to have caused a fire, the defendant can opener manufacturer will eventually claim that all of the other appliances on the kitchen countertop should also have been preserved. If all the appliances are saved, the defense will contend that the wiring in the wall behind the counter should have been preserved. If the wiring is secured, the defense will contend that it should not have been removed from the wall before the defense could inspect it in place, and that all electrical devices in the adjoining room should also have been saved.

The goal is to make whatever criticisms are eventually leveled at your investigation seem beyond the realm of reason. The safest course, as far as evidence preservation is concerned, is to do everything that common sense suggests should be done, and then go at least one step beyond that, if possible.

B. Other Considerations

Safely navigating the evidence spoliation minefield only keeps you in the game. It does not win the case. Taking precautions to prevent critical evidence or even an entire case from being thrown out based upon evidence spoliation allegations should not overshadow the

more mundane but equally important task of gathering the evidence, documentation and information in the immediate aftermath of a loss that may bolster your case, while the evidence is still available. This process, which is discussed at greater length in the accompanying articles, includes:

1. Not only seeing to it that the site is thoroughly photographed and videotaped, with critical dimensions sketched out on diagrams or drawings, but also asking around about any photographs or videotapes others may have taken during or following the incident. A surprisingly large number of fires and other catastrophes are now videotaped while they are still in progress by freelance videographers who monitor emergency radio bands, as well as by bystanders who happen to have a camcorder handy and by conventional news outlets;
2. Identify potentially important witnesses and get their stories while the witnesses are still available and talkative and their memories are still fresh. Decide whether or not to attempt to secure written or recorded statements from the witnesses, recognizing that you probably would eventually have to produce any witness statements you do obtain, even of your insured's own personnel. On the other hand, attorney notes of interviews are normally deemed privileged or non-discoverable work product, but cannot usually be used to impeach a witness or refresh their recollection;

3. Gather pertinent documentation from the insured or other interested parties. Much potentially important information, such as recordings of "911" calls and burglar and fire alarm records, are purged after relatively brief periods. If not requested and obtained shortly after a loss, it may never again be available;

4. "Save the twins". The light fixture, air compressor, or other device that is alleged to have caused the fire could well have been purchased and installed on the premises at the same time as one or more essentially identical devices that probably rolled off the assembly line minutes before or after the accused device. Examining such undamaged exemplars is of invaluable assistance in identifying the failure mode in the accused product, and will assist in leveling the playing field against a product manufacturer who is going to be intimately familiar with that product. Exemplars of the same model and vintage as the accused product are often hard to come by, if they are not available at the loss site.

II. POTENTIAL OBSTACLES TO RECOVERY

A. Avoiding Contractual Limitations

1. Is Your Insured a Party to the Contract?

Non-parties to a service contract may nevertheless have a right to bring a claim against the service provider that is unaffected by any liability limitation provisions in the contract. For example, in Scott and Fetzer Co. v. Montgomery Ward and Co., 112 Ill. 2d 378, 493 N.E.2d 1022 (1986) the Illinois Supreme Court held that a fire alarm company was

potentially liable to non-parties to the contract who suffered foreseeable property losses as a result of the failure of a fire alarm system to function properly, and that the claims of such non-parties were not subject to the liability limitation provisions of the alarm contract.

2. Does the Contract Even Apply to the Claim?

For example:

a. In the case of a loss involving an American Institute of Architects ("AIA") construction contract, which almost invariably includes provisions prohibiting subrogation claims for damage to the "work" that is the subject matter of the contract, consider whether the claim at issue involved damage to the "work".

b. Consider whether a subrogation waiver in a construction contract applies to damage which first occurs long after the construction project has been completed. Fairchild v. W. O. Taylor Commercial Refrigeration, 403 So.2d 1119 (Fla. App. 1981).

c. Consider whether a waiver of subrogation clause in a lease necessarily protects the landlord from liability for negligence in a capacity other than as a landlord, such as when the landlord negligently conducts operations on adjoining property which damages the insured's premises.

3. Is the Contractual Limitation Valid Under the Governing Law?

There may be consumer protection statutes or similar provisions which invalidate contractual limitations, although these are less likely to apply to commercial parties, and even less likely to benefit subrogating insurers.

4. Was There Adequate Notice of or Consent to the Liability Limitation Provision to Render Enforcement?

Normally, parties are deemed to have notice of and to have consented to anything contained in a written contract that they sign. An exception to this general rule may apply where a party had no opportunity to bargain for different terms. Additionally, a subrogation waiver may not be enforceable if the insurer had no notice of it and did not consent to it. Some courts have required that subrogation waivers be mutual and that both insurers' policies authorize the waiver. However, such authorization typically appears in standard policy forms.

5. Are There Liability Theories Independent of the Contract?

Again, the ability to avoid contractual limitations based upon non-contractual theories is more likely to succeed with claims by or on behalf of non-commercial entities. Also, the ability to pursue non-contractual claims may hinge upon the applicability of the economic loss doctrine, discussed in the next section.

6. Are There Other Potential Defendants Who Do Not Benefit from the Contractual Limitation Provision?

7. Was There Gross Negligence, Intentional Wrongdoing, or Other Aggravated Fault That Might Override the Contractual Limitation?

B. Economic Loss Doctrine

Over the past decade or so, the expansion of the economic loss doctrine has encroached upon the ability to successfully pursue many kinds of subrogation claims, and has probably had an even more profoundly adverse impact upon subrogation litigation than has the expansion of the evidence spoliation doctrine. The economic loss doctrine defines the kinds of damages that are recoverable, if at all, only under a contractual theory of liability. When

applicable, the doctrine can have a devastating impact upon subrogation claims, because contractual theories are often precluded either by liability limitations or disclaimers in the contract itself, or because such claims are barred by the statute of limitations. Unlike tort claims such as negligence or strict liability, where the statute of limitations begins running on the date a loss occurred, the statute of limitations typically begins to run on contractual claims from the date the contract was formed, as opposed to the date a loss occurred, which could be years later. Thus, the statute of limitations on contractual claims often has expired long before a loss has even occurred.

There have always been some distinctions and limitations on the damages that could be recovered under tort theories of liability, as opposed to contractual theories. These distinctions and limitations go back to an era when there was no such thing as strict liability in tort. Over the past forty years, the economic loss doctrine has evolved in conjunction with the advent and development of the doctrine of strict liability for defective products. While the economic loss doctrine is not confined solely to product liability claims, economic loss issues often arise in product liability claims involving property damage. The courts had to decide whether the recoverability of damages claimed under newly-adopted product liability theories should be evaluated under tort rules or contract rules.

As the economic loss doctrine evolved, various jurisdictions adopted a variety of definitions of non-recoverable "economic loss". The results in similar cases decided in different parts of the country were literally "all over the map". Some courts held that damages resulted from a product's simple failure to live up to its expectations were recoverable in tort (City of LaCrosse v. Schubert, Schroeder & Associates, 72 Wis. 2d 38, 240 N.W. 2d 124 (1974)), while some courts held that such damages were not recoverable. Some courts said that the value of a

product that self-destructed, as well as any consequential damages resulting from the loss of the product, were recoverable under tort law. Some courts said that they were not. Many other courts adopted a "middle ground," where the recoverability of damages resulting from the self-destruction of a product hinged upon whether the self-destruction occurred in a "sudden and calamitous" and potentially dangerous fashion.

In a 1985 case, East River Steamship Corporation v. Transamerica Delaval, Inc., 476 U.S. 858 (1986), the U.S. Supreme Court held that damages resulting from a product's self-destruction were never recoverable in tort. East River was a case involving a federal admiralty claim. Almost all product liability and tort claims involve state, not federal law, even where a case is pending in federal court. Therefore, East River is technically controlling in only a very few cases. Nevertheless, most courts that have confronted these issues since 1985 have adopted at least as broad a definition of non-recoverable "economic loss" as that adopted by the U.S. Supreme Court in East River.

Many courts have expanded the doctrine to preclude recovery of any damages, including property damages, that were deemed "foreseeable" at the time the products were sold or the contract entered into, particularly when the claim is made by or on behalf of a commercial party. The theory is that the claimant should have "bargained for" a right to recover such foreseeable losses at the time of the contract or sale. The Michigan state and federal courts have adopted this position in cases such as Neibarger v. Universal Cooperatives, Inc., 439 Mich. 512, 486 N.W.2d 612 (1992) and Michigan Mutual Insurance Company v. Osram Sylvania, Inc., 1997 W.L. 189545 (6th Cir. 1997). In Michigan Mutual, for example, a 400 watt light bulb exploded, causing a multi-million dollar fire in a manufacturing facility. The court held that the strict liability claim against the light bulb manufacturer was barred by the economic loss doctrine, on

the theory that the light bulb purchaser could and should have "foreseen" the inherent risk of fire associated with a 400 watt light bulb and negotiated an appropriate allocation of that risk at the time the bulb was purchased.

Few, if any, other jurisdictions have adopted the extreme view of the Michigan courts that any arguably "foreseeable" losses associated with a defective product are barred under the economic loss doctrine. For example, in Lloyd Smith Company, Inc. v. Den-Tal-Ez, Inc., 491 N.W.2d 11 (Minn. 1992), the Minnesota Supreme Court held that damages to other property from a fire caused by a defective dentist's chair were recoverable under a strict liability theory, even though the damage to the chair itself was not. However, in Fireman's Fund American Insurance Company v. Burns Electronic Security Services, Inc., 93 Ill. App. 3rd 398, 417 N.E.2d 131 (1980), the court held that the plaintiff could not avoid a contractual limitation of liability in a burglar alarm contract by asserting a negligence claim, because the losses claimed by the plaintiff were the foreseeable result of the alarm's failure to perform the very purpose it was intended to perform - to prevent burglaries.

C. Pursuing Subrogation Against Your "Own Insured"

It is common knowledge that you cannot pursue subrogation against your own insured. It would not be logical or fair to pay an insured benefits under a policy, and then seek to take those benefits back by means of a subrogation claim.

However, determining who the "insured" is against whom pursuit of subrogation is prohibited is not always clear-cut. Common sense would suggest that the answer to this question lies in the Declarations Page and the Definitions section of the policy. However, that does not always answer the question. Under the "implied coinsured" doctrine, many states, including Illinois, Michigan and Minnesota, presume that landlords and tenants are normally

"implied coinsureds" under one another's policies, particularly, but not necessarily, if the lease required landlord and tenant to insure their respective property. Dix Mutual Insurance Co. v. LaFramboise, 597 NE 2d 622 (Ill. 1992); New Hampshire Ins. Group v. Laombard, 399 N.W. 2d 527 (Mich. App. 1986); United Fire and Casualty Co. v. Bruggeman, 505 N.W. 2d 87 (Minn. App. 1993). As "implied coinsureds", the land-lord and tenant are immune from subrogation claims by one anothers' liability insurers, even if there is no express subrogation waiver or other liability limitation in the lease. Other courts have rejected the "implied coinsured" doctrine. Neubauer v. Hostetter, 485 NW 2d. 87 (Iowa 1992).

The rule against pursuing subrogation against your "own insured" is also sometime asserted when a subrogation target happens to have primary or some layer of excess liability coverage under a separate policy with the same company as the claimants' property insurer or the property insurers' parent, subsidiary or sister company. There are only a very few reported decisions on the subject. See, e.g., Home Ins. Co. v. Pinski Bros., 160 Mont. 219, 500 P.2d 945 (1972). Most courts would recognize that there is no prohibition against pursuit of subrogation in that context and that there may often be valid reasons for pursuing such a claim.

The analysis does not necessarily end when an "insured" is identified as such in the policy. For example, Builders' Risk policies typically identify as insureds all subcontractors "as their interest may appear". There is considerable debate as to whether or to what extent subrogation is prohibited against a subcontractor that is so identified. The majority, but not universal, position is that subrogation is completely prohibited. South Tippecanoe School District v. Shambaugh & Sons, 395 NE 2d 320 (Ind. 1979). Some courts hold that subrogation against such a subcontractor is precluded only to the extent of the subcontractor's own "interest"

in the insured property. Turner Construction Co. v. John B. Kelly Co., 442 F.Supp. 551 (E.D. Pa. 1976).

IV. DAMAGES ISSUES

1. As discussed in the attached article entitled "Proof of Damages in Subrogation Actions: Problems and Solutions", It is important to recognize differences in the measure and proof of damages recoverable under the insurance policy as opposed to the damages recoverable from a third-party tortfeasor. The cost to repair or replace the damaged property is normally recoverable only to the extent that it does not exceed the difference in market value of the property before and after the loss, at least where the property is owned for business or investment purposes rather than for personal use. Matich v. Gendes, 550 N.E. 2d 622 (Ill. App. 1990). Sometimes, the evidence developed during the adjustment process will not be sufficient to meet the burden of proof under the measure of damages applicable to the subrogation claim. For example, if it is clear that a "market value" measure of damages to a structure is the only appropriate standard, it may be necessary to hire a qualified real estate appraiser in order to substantiate the recoverable damages.

2. Pro-Ration Agreements:

The reasons for entering into pro-ration agreements with the insured are discussed at length in the attached article on that subject. In situations where the insured suffered losses that were either not covered or exceeded the coverage available under the policy, a growing number of jurisdictions have held that the insured is entitled to be "made whole" out of any funds recovered from a tortfeasor before the insurance company receives any portion of the recovery. One of the leading cases adopting this "insured whole" rule is the 1977 decision of the Wisconsin Supreme Court in Garrity v. Rural Mutual Insurance Co., 77 Wis. 2d 537, 253 NW 2d

512 (1977). Other cases adopting the same rule include Westendorf v. Stasson, 330 N.W. 2d 699 (Minn. App. 1983); Hardware Dealers Mut. Fire Ins. Co. v. Ross, 129 Ill. App. 2d 217, 262 N.E. 2d 618 (1970); and Shelter Ins. Cos. v. Frohlic, 243 Neb. 111, 498 N.W. 2d 74 (1993). Under a pro-ration agreement, the insurance company and the insured share in any recovery from the first dollar based upon agreed-upon percentages, which normally, but not necessarily, correspond to the recoverable damages claimed by each party. Expenses incurred in pursuing the joint claim are allocated according the same percentages, although the insurance carrier will typically, but not necessarily, advance the expenses during the course of the case, and obtain reimbursement of the insured's share of expenses out of the insured's share of the recovery at the end of the case.

Both parties benefit from a fair pro-ration agreement. Of course, the insurance carrier avoids the potential application of the "insured whole" doctrine. However, the insured benefits as well. The amounts paid by the insurer are often considered more "solid" than the claimed uninsured losses. An agreement up front as to how recoveries will be allocated between the insurer and the insured eliminates the potential for a future dispute between the insurer and the insured over the actual value of the uninsured losses, which plainly benefits the insured. Such an agreement should also eliminate any other potential conflicts between the parties. Because the insured has a definite stake in the litigation, the insured has more incentive to cooperate actively in the subrogation case, which can drag on for years after the insured's claim has been paid. The insured also benefits from the resources that the insurance company can bring to bear on the pursuit of the subrogation claim.

The key to negotiating a fair pro-ration agreement is to verify what the actual "uninsured" losses are. This means that, even when a loss clearly exceeds policy limits or sub-

limits, the adjuster should nevertheless establish the total amount of the losses sustained for each element of the insured's claim, both on an actual cash value and replacement cost basis.