



Denenberg Tuffley *Times*

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DENENBERG TUFFLEY TIMES is a quarterly newsletter providing updates on noteworthy recent cases and statutory changes from across the country regarding subrogation or property/liability insurance coverage issues.. Case summaries and articles are written by attorneys from the firm's offices in Michigan and California.

If you have any questions regarding this newsletter, would like copies of the cases which are discussed, or have suggestions on topics to be addressed in future issues, please contact Jeffrey Learned [jlearned@dt-law.com] or Alyssa Endelman [aendelman@dt-law.com], both in the firm's Michigan office. For further information regarding Denenberg Tuffley, PLLC, please visit our web site at www.denenbergtuffley.com.

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Subrogation in the News

Colorado Supreme Court Holds That The AIA Waiver Of Subrogation Does Not Apply To Claims For Damage To Non-Work Property

Many contractors use the standard form American Institute of Architects ("AIA") construction contract regarding a construction project. The waiver of subrogation provision in that form contract states "[t]he Owner and Contractor waive all rights against each other and any of their subcontractors... for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to [the contract]... or other property insurance applicable to the Work." The contract only requires that the property owner insure "the Work," which is the property subject to the construction contract.

Confusion arises where the property owner insures both the Work and property not the subject of the construction contract ("non-Work property") under the same property insurance policy. If the contractor causes a loss which damages both the Work and non-Work property, does the waiver of subrogation bar claims for damage to both types of property? A majority of courts hold that it does, as the underlying policy is "applicable to the Work" (even though it is also "applicable" to non-Work property as well). The minority of courts take a more reasoned approach, holding that the waiver of subrogation is limited to claims for damage to the Work, as that is the only property the owner is required to insure under the AIA contract.

Recently, the Colorado Supreme Court joined those jurisdictions that correctly limit the scope of the AIA waiver to claims for damage to the Work. In *Copper Mountain, Inc. v Industrial*

Systems, Inc., 2009 W.L. 662072 (Colo. Sup. Ct. 3/16/09), Copper Mountain, Inc. hired Amako Resort Construction, Inc. as the general contractor to renovate and expand a mountain resort lodge. Amako subcontracted with Industrial Systems, Inc. to build the steel framework for the project. The parties signed a standard AIA form construction contract, which required Copper Mountain to obtain property insurance to cover damages to the Work. To comply with this requirement, Copper relied on its existing property insurance policy that provided coverage for all of the resort, including both the Work and adjacent properties. The contract also contained the waiver of subrogation provision discussed above.

A fire started while Industrial was welding the steel framework, damaging portions of the existing lodge that were not the subject of the construction contract (non-Work property). In subsequent litigation, both the trial court and the Colorado Court of Appeals held the waiver of subrogation barred claims for damage to both the Work and non-Work property.

The Colorado Supreme Court disagreed. It held that since the contract a) required the owner (Copper) to provide property insurance coverage only for the Work, and b) required the contractor (Amako) to procure liability insurance coverage for damage caused to non-Work property, logic dictated the waiver of subrogation operated along those same lines. Therefore, the waiver of subrogation only applied to claims for damage to the Work.

Those courts which have followed the majority rule appear to be motivated not so much by a desire to give meaning and effect to the underlying contract provisions, but by a desire to minimize litigation. Those courts, such as the Colorado Supreme Court in *Copper Mountain*,

Denenberg Tuffley Subrogation Manual – Version 2.0 Is Coming Soon!

As many of you know, to assist our insurer clients our firm created a Subrogation Manual. The over 60 page Manual addresses a variety of topics relevant to subrogation, including the roles of the adjuster/attorney/experts in the subrogation investigation, statutes of limitation and repose (including shortened statutes and/or special notice requirements for claims against governmental entities and others), whether the target defendant may be considered an insured under the subject property insurance policy (owners/contractors and landlord/tenant are two common examples), various legal defenses to subrogation actions (including waivers of liability and subrogation) and the “insured made whole” issue. The Manual also contains several 50 state surveys, including surveys on statutes of limitations and repose, the economic loss doctrine and the apportionment of subrogation recovery. Many of our insurer clients have told us the Manual is not only an excellent resource for training new subrogation examiners, it is also a very useful reference tool that their subrogation departments use on a regular basis.

We are very pleased to announce that the firm is working on a Version 2.0 of the Subrogation Manual, and we hope to have it completed by the end of September 2009. The topics discussed will be expanded to include joint and several liability of defendants, comparative and non-party fault, the measure of recoverable damages and other topics as well. Moreover, to make the Manual more user-friendly as a reference tool, we will include state-by-state summaries of the law on over 20 topics, including apportionment of subrogation recovery, the measure of damages for business interruption/personal property damage/real property damage, pre-judgment/postjudgment interest, loan receipts, spoliation of evidence and applicable statutes of limitations and repose.

Needless to say, the Subrogation Manual represents a significant undertaking by our firm, and is further evidence of our continuing commitment to our subrogation clients. If you or your Company want to make certain you receive Version 2.0 when it comes out, please e-mail our firm’s CAO, Terri Spitzig, at denenbergtuffley@gmail.com.

which actually examine the underlying contract’s insurance requirements reach a different conclusion, one in harmony with those requirements. As subrogation professionals, we can only hope that more courts look towards this ruling and adopt its well thought out reasoning.

Alyssa J. Endelman
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The U.S. Court Of Appeals For The Sixth Circuit Changes Course, And Holds Federal Courts Should Not Rely On State Law Regarding Spoliation Of Evidence

Unlike other federal appellate courts that have addressed the issue, the United States Court of Appeals for the Sixth Circuit (the Sixth Circuit includes Kentucky, Michigan, Ohio and Tennessee) has long held that federal courts should look to state law to determine whether a party should be sanctioned for spoliation of evidence. *Beck v Haik*, 377 F.3d 624 (6th Cir. 2004); *Nationwide Mutual Fire Ins. Co. v Ford Motor Co.*, 174 F.3d 801 (6th Cir. 1999); *Welsh v United States*, 844 F.2d 1239 (6th Cir. 1988). However, the Sixth

Circuit Court of Appeals recently overruled these prior decisions, holding that “a federal court’s inherent powers include broad discretion to craft proper sanctions for spoliated evidence.” *Adkins v Wolever*, 554 F.3d 650, 651 (6th Cir. 2009).

This change in precedent resulted in the court setting forth a new “standard” for its district courts to employ when determining what, if any, spoliation sanctions are appropriate:

As our sister circuits have recognized, a proper spoliation sanction should serve both fairness and punitive functions... Because failures to produce relevant evidence fall along a continuum of fault-ranging from innocence through the degrees of negligence to intentionality, the severity of a sanction may, depending on the circumstances of the case, correspond to the party’s fault. Thus, a district court could impose many different kinds of sanctions for spoliated evidence, including dismissing a case, granting summary judgment, or instructing a jury that it may infer a fact based on lost or destroyed evidence.

554 F.3d at 651. Accordingly, the Sixth Circuit has given trial courts broad discretion in deciding what constitutes an appropriate sanction for spoliated evidence.

In the two months since *Adkins* was decided, this “broad discretion” standard has been applied in three separate civil suits where spoliated evidence was an issue. *Jennings v Bradley*, 2009 W.L. 537659 (W.D. Mich. 2009); *McClain v Norfolk Southern Railway Co.*, 2009 W.L. 701001 (N.D. Ohio 2009); *Technical Sales Associates, Inc v Ohio Star Forge Co.*, 2009 W.L. 728520 (E.D. Mich. 2009). These opinions provide some insight into the factors a federal court in the Sixth Circuit will consider in deciding whether to sanction a party for spoliation of evidence – 1) the timing of the spoliation relative to the subject litigation, 2) the role, if any, that the parties to the litigation played in the evidence being spoliated, 3) the availability of other evidence supporting the same facts/arguments as the spoliated evidence, and 4) the credibility of the party that allegedly benefits from the spoliation.

In short, it appears these courts will be looking for facts tending to show that the evidence was intentionally/knowingly spoliated to limit its impact in litigation.

If such evidence exists, extreme sanctions may well be imposed. Conversely, if a third-party (such as a fire department when fighting a fire) spoliated the evidence, or if there is no evidence of any intent to spoliolate evidence (perhaps evidence was accidentally disposed of), there could be no spoliolation sanction at all.

*Paul A. Casetta
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California Appellate Court Enforces Waiver Of Subrogation In A Lease, Despite The Tenant's Failure To Comply With Terms And Conditions Of The Lease

In *Fireman's Fund Insurance Company v. Sizzler USA Real Property, Inc.*, 169 Cal. App.4th 415 (2008), the insured, Santa Monica Collection LLP (SMC), owned a shopping center. Sizzler USA Real Property, Inc. (Sizzler) was a tenant. Besides requiring that Sizzler indemnify SMC for personal injury caused to third parties on the premises, the lease stated Sizzler must maintain \$1 million in liability insurance, and include SMC an additional insured on that liability policy. The lease also contained a waiver of subrogation, which stated "the parties release each other and their respective authorized representatives from any claims for damage to any person or property of either landlord or tenant... about the premises that are caused by or result from risks insured against under any insurance policies carried by the parties..."

The lease permitted Sizzler to assign or sublet the premises, provided that Sizzler would remain liable for the performance of all obligations under the lease. Sizzler sublet the premises to a nightclub known as Sky Sushi. In September 2002, a patron of Sky Sushi was attacked and stabbed. As a result of his injuries, the patron filed suit against SMC and others.

Pursuant to the lease, SMC sought indemnification from Sizzler. Sizzler tendered the claim to its liability carrier (Federal Insurance Company), which provided only \$750,000 coverage (after a self-insured retention of \$250,000). However, since SMC was not named as an ad-

ditional insured under the Federal policy, SMC's insurer, Fireman's Fund Insurance Company, defended SMC.

SMC paid \$300,000.00 to settle the personal injury claim, and incurred \$84,101.00 in defense costs. Fireman's Fund then initiated suit against Sizzler to recover these amounts. Sizzler asserted that the lease's subrogation waiver barred Fireman Fund's action. Fireman's Fund countered that the subrogation waiver was not a bar because Sizzler failed to obtain liability insurance fully covering SMC for \$1 million, and failed to name SMC as an insured under the Federal liability policy, as required by the lease. This constituted non-performance of a condition precedent to the subrogation waiver, and also represented a lack of consideration for the waiver.

The matter eventually made its way to the California Court of Appeal, which rejected Fireman's Fund's arguments. The court rejected Fireman's Fund's assertion that Sizzler's procurement of full insurance (and naming SMC as an insured under the policy) was a condition precedent to operation of the subrogation waiver. In California, "the rule is that provisions of a contract will not be construed as conditions precedent in the absence of language plainly requiring such construction." The Fireman's Fund court found no express language stating that Sizzler's obligation to obtain full insurance coverage was a condition precedent to the operation of the subrogation waiver.

The court further rejected Fireman's Fund's argument that Sizzler's failure to carry a full \$1 million of insurance constituted a failure of consideration for the subrogation waiver. The court held that Sizzler's breach of its insurance obligation under the lease was only a partial breach that did not constitute a failure of consideration of the entire lease.

Fireman's Fund is another example of courts aggressively enforcing waivers of subrogation in lease agreements, even where a closer examination of the facts supports a contrary result. Unfortunately, there is no indication this general trend in the law will end any time soon.

*David A. Leeds
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Michigan Supreme Court Limits The Impact Of Non-Party Fault Statute

As part of the wave of "tort reform" statutes enacted throughout the country, many states abolished joint and several liability, replacing it with non-party fault. This permits a defendant to identify various non-parties to the litigation which it claims were responsible (to some degree) for the plaintiff's damages. The jury must then allocate fault to the defendant, the plaintiff and all non-parties. To the extent fault is allocated to a non-party, the corresponding damages cannot be recovered. [For example, if there are \$1,000,000 in damages, and the jury allocates 30% fault to a non-party, the plaintiff will be unable to recover \$300,000 from any party].

Non-party fault can be a potent weapon for a defendant, reducing its exposure for the plaintiff's damages (this includes a subrogated insurer). Since the non-party will not actually be required to pay any damages corresponding to its percentage of fault, fault can be ascribed to parties who would otherwise be shielded from liability. This includes governmental entities (shielded via governmental immunity), parties who contracted with the plaintiff (shielded via contractual disclaimers of liability), and/or parties who are immunized from liability by operation of law (such as architects or contractors who are shielded via the expiration of the statute of repose). In short, non-party fault may reduce a plaintiff's recovery by allocating fault to parties who the plaintiff cannot sue.

In Michigan, joint and several liability was abolished by M.C.L.A. §600.2956, which states "in an action based on tort or another legal theory seeking damages for personal injury, property damage, or wrongful death, the liability of each defendant for damages is several only and is not joint." A corresponding statute, M.C.L.A. §600.6304, states that "[i]n an action based on tort or another legal theory seeking damages for personal injury, property damage, or wrongful death," a jury shall allocate a percentage of fault to non-parties.

Until recently, Michigan law was not settled on two important questions regarding these statutes. First, must a non-party actually owe some sort of duty of care to

the plaintiff in order for it to be allocated non-party fault? Second, do non-party fault rules apply to all claims for damages (tort and contract), or just to tort claims? Since these questions were unanswered, defendants were quite liberal regarding their allegations of non-party fault, and many courts were equally broad in their application of non-party fault rules (all to the detriment of plaintiffs, including many subrogated insurers).

In the early Spring of 2009, the Michigan Supreme Court answered both questions, and in so doing has provided reasonable limitations on non-party fault rules. With regard to the duty question, the court in *Romain v Frankenmuth Mutual Insurance Co.*, 483 Mich. 18, 762 N.W.2d 911 (2009) held that a party must owe a duty to the plaintiff in order for non-party fault to be allocated to it. It cogently reasoned as follows:

...[Pursuant to Michigan statute, fault is defined as] "a breach of a legal duty... that is a proximate cause of damage sustained by a party." Before there can be "a breach of a legal duty," there must be a legal duty. Without owing a duty to the injured party, the "negligent" actor could not have proximately caused the injury and could not be at "fault" for purposes of the comparative fault [including non-party fault] statutes.
— 762 N.W.2d at 913-914.

The second question was answered (albeit indirectly) in *Zahn v Kroger Company of Michigan*, 483 Mich. 34, 764 N.W.2d 207 (2009). In that case, by contract a subcontractor ("the SC") was required to indemnify the general contractor ("the GC") for damages arising out of the SC's acts or omissions. An employee of the SC was injured on the job, and filed a personal injury lawsuit against the GC. The GC filed a third-party claim against the SC for contractual indemnification. After the GC settled the personal injury claim, it sought to enforce the contractual indemnification provision against the SC.

The SC argued that contractual indemnification provisions are subject to M.C.L.A. §600.2956, which abolished

joint and several liability in Michigan; therefore, the contractual indemnification provision is unenforceable. The Michigan Supreme Court disagreed, holding that "M.C.L.A. §600.2956 does not apply to contract actions." 764 N.W.2d at 210.

While the *Zahn* court was not asked to rule on any non-party fault issues, logic dictates that its holding also means there should be no allocation of non-party fault under M.C.L.A. §600.6304 where a breach of contract is concerned. The entire system of allocating fault to non-parties was a consequence of the abolition of joint and several liability under M.C.L.A. §600.2956. If, as *Zahn* indicates, joint and several liability still applies to contract claims, then there is no need for non-party fault regarding such claims. Indeed, a non-party fault scheme is contrary to joint and several liability. Subrogated insurers should keep this in mind when deciding what causes of action to assert in a subrogation action in Michigan.

Jeffrey R. Learned
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Subrogation Update – Recovery Potential Arising Out Of The 2008 And 2009 California Wildfires

Denenberg Tuffley has been extensively involved in the litigation of the 2007 San Diego Wildfires. In the process, we assembled a team of some of the most experienced and reputable experts in their respective fields. On behalf of several of our insurer clients, we are currently working with these experts on investigating a number of 2008 and 2009 California Wildfires, and determining whether subrogation potential exists. While our investigation continues, there appears to be definite subrogation potential regarding at least four of these fires.

The Sesnon Fire — This wildfire started on October 13, 2008, in the Porter Ranch Community area of the San Fernando Valley. It then spread into the Simi Valley area in Ventura County. As a result, over 14,000 acres, 15 homes and 63 outbuildings were destroyed. At least 11 additional homes suffered damage as well. Initial investigation reveals that a downed transmission line owned by the Southern California Gas Company (SCG) caused the subject fire. It

is suspected that SCG's failure to properly maintain transmission lines, along with its failure to adequately maintain vegetation clearance from its lines, were responsible for causing the fire.

The Sayre Fire — Also known as the Sylmar Fire, this wildfire started on November 14, 2008 in the Los Angeles area (north of the 210 Freeway near Veterans Memorial County Park). The fire burned over 11,000 acres and destroyed more than 600 structures, including 480 mobile homes, nine single family homes, 104 outbuildings and 10 commercial buildings. We continue to investigate the cause of the fire, but it appears downed power lines ignited combustible vegetation.

The Freeway Complex Fire — This wildfire started on November 15, 2008, near the westbound 91 Freeway in the City of Corona (Riverside County) and the Olinda Alpha Landfill. This fire burned approximately 30,305 acres of land, 187 residential structures, 2 commercial properties, and 11 outbuildings. Additionally, 127 residences, 2 commercial properties and 32 outbuildings were damaged. Initially, it was believed vehicle exhaust or a carelessly discarded cigarette caused the fire. However, our investigation shows that downed power lines may have played a role in the start of the fire.

The Jesusita Fire — Initially called the Santa Barbara fire, this wildfire started on May 5, 2009. It burned 8,733 acres and destroyed 80 homes, 79 outbuildings and 1 commercial property. 15 homes and 2 outbuildings were also damaged. It is estimated that total damages will exceed \$17,000,000.00. The origin and cause of the fire remains under investigation. However, our initial investigation suggests that individuals working to remove brush and combustible vegetation to comply with vegetation clearance requirements were using a power tool that started the fire.

We strongly suggest that all insurers verify whether any of their insureds suffered losses in these fires. If so, we will be happy to assist any insurer in pursuing subrogation recovery. If you have further questions, or would like our assistance, please contact Todd Denenberg or Alan McMaster in our Michigan office, or Pamela Gelman in our California office.