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Consider secondary sources for recovery when your subrogation efforts seem to have nowhere to Gogh

Risk of property loss or damage is always a major concern for business and property owners, but perhaps more so when that property is fine art, jewelry, cash, or other rare or unique items. Insurers often require those involved in the storage or display of such property to take significant precautions to minimize potential losses. Nevertheless, damage, theft and the destruction of valuable items still occurs. In the UK, the largest loss of fine art in recent times occurred following a fire at an art storage depot in London in 2004. Works by artists including Tracy Emin and Damien Hirst were completely destroyed, and legal action against Momart, the company that ran the depot, resulted in out of court settlements which ran into the millions.

For insurers who indemnify an insured for losses of this nature, it may not always be possible, or feasible, to pursue a subrogated claim against the person or entity directly responsible for the incident which caused the loss. For example, an individual who negligently left open a point of access to an otherwise secure building, but who may have extremely limited financial means, making any judgment against them a somewhat pyrrhic victory. The responsible party could even be the insured itself, or an unknown perpetrator.

However, when the loss occurs in whole or in part because protections put in place to guard against that loss fail to perform as expected, insurers may be able to identify a secondary target, for example a fire or burglar alarm installer and/or maintenance company. Even construction professionals and product manufacturers could be exposed to potential liability, as building designs often incorporate features intended to limit the damage caused by fire, such as fire suppression systems and structural components that prevent the spread of a fire from one space to another.

The poor design or implementation of structural safeguards and fire systems can lead to damage that never should occur. In the event of water or fire damage to valuable items, attention should be paid to the adequacy of the design and installation of monitoring/ prevention equipment, for example the number and positioning of sensors or sprinkler heads, and any construction features specifically designed to prevent or limit the spread of damage, as well as defective products, e.g. faulty sprinkler heads or alarm panels.

In the UK case of Trebor Bassett and Cadbury v ADT Fire and Security (2012), ADT had designed and installed a fire suppression system in a factory used for the production of confectionery. The system was supposed to discharge carbon dioxide into a specific part of the factory machinery when a fire was detected. However, the system failed, and smoldering popcorn developed into a fire which spread and destroyed the entire factory. The court decided that ADT had breached its contract with Cadbury by designing a system which contained fundamental flaws as regards the choice of fire sensor and its location, which was away from the area of the factory where a fire was likely to be strongest.

In the US, in the New York federal case Regent Ins. Co. v. Storm King Contracting, Inc. (2008), the court allowed a subrogating insurer to proceed with claims against a fire sprinkler system designer and installer. A fire started in a hotel and its rapid spread to other areas of the building resulted in a total loss of the structure. It was discovered after the fire that many parts of the hotel lacked sprinkler devices, and this allegedly failed to meet building codes and professional standards.

Fire sprinkler systems are the most common device employed to prevent the spread of fire. However, many buildings are often designed and constructed with additional safety measures and, when these fail, a claim can arise against negligent professionals. The UK courts have even held that using construction materials which increased the risk of loss amounts to negligence. In Sahib Foods v Paskin Kyriakides Sands (2003), the defendant architects had been retained to refurbish a factory. As part of the refurbishment, combustible polystyrene panels were used in the walls of a food preparation area. This was even after a third party had recommended the use of fire retardant panels instead. When a gas flame was left switched on, the fire spread to the wall panels and then to the rest of the property. If fire retardant panels had been used, only one room in the property would have been damaged. The court decided that, while there was negligence on the part of the factory owner, the architects had also been negligent because they should have advised the owner to fit panels to guard against the risk of fire.
In the US, building codes often require that walls provide certain measures of fire resistivity. In the Ohio federal court case American States Insurance v. Hannan Construction (1966), the court upheld judgment against building developers and contractors in favor of two property insurers who proved to the jury that a fire was exacerbated by a patent lack of fire resistant construction required by Ohio's building code.

In addition to pursuing potential recoveries for losses caused by construction defects or faulty damage prevention systems, insurers should also consider whether an individual or business engaged to provide security services has failed in its duty.

Where an insured has employed a security company to patrol or monitor its premises, but has suffered a theft, for example at a warehouse or an art gallery, insurers should consider what the duties of that company were, and whether it met them to an acceptable standard. For example, how regularly should security personnel have patrolled, and what were the camera monitoring requirements? If there is some indication that security personnel were inexperienced or negligent, what vetting process took place?

In the UK case of Schimon Schestowitz Ltd v Security (North West) Ltd (2001), items worth over $95,000 were stolen from a warehouse. The owner claimed against the private security company, arguing that the defendant was liable for its employee guards' negligence. Unfortunately for the claimants, they could not show that the theft actually took place at the time when a guard was, or should been, on duty. However, the judge did note that, given the scale of the theft, it seemed to be highly likely that any guard on duty either participated in the theft or was negligent, in which case the defendant would be liable.

In the US, the Florida case Burns International Security Services v Philadelphia Indemnity Insurance (2005), a subrogation case involving a warehouse theft, held that security firms have a duty to exercise reasonable care to guard third parties against criminal acts when the firms have contractually agreed with another "to do just that." In particular, the Burns opinion suggests that security firms must provide adequate physical security, hire qualified

employees, and adequately train security officers.

The UK courts have also frowned on security companies who do not adequately monitor security or fire alarm equipment, or respond to the activation of an alarm in a timely or logical manner. In some cases, these failures have led to millions of pounds worth of damage. In Grand Pier v System 2 Security (2012), a fire completely destroyed a pleasure pier. System 2 Security had been contracted to monitor the fire alarm, and had subcontracted the work to an alarm receiving company. In this case, the company tried to call one key holder, but then did not notify the fire service when attempts to contact the key holder failed. The judge's view was that there was no good defense to the claim because the security company had failed to ensure that its subcontractor had contact details for two key holders or that the subcontractor would notify the fire service as a default if they could not be contacted. The pier was eventually rebuilt at a cost of £39m.

In the earlier case of Bailey v HSS Alarms (2000), burglars stole and damaged property from business premises after the security company contracted to monitor the burglar alarm system, HSS, dialed the wrong telephone numbers for the building's key holders. HSS were actually subcontractors of the alarm's installers, so they did not have any direct contractual relationship with the Baileys. Nevertheless, the court decided that HSS did owe them a duty of care. HSS were being paid to monitor the alarm, held personal information about the Baileys, and must have known that the Baileys were relying on them to properly carry out the services. The Baileys were entitled to be compensated not only for the value of the stolen and damaged property, but also for the loss of profits suffered by the business while equipment was replaced and repairs carried out.

In the US, alarm installation and monitoring contracts often contain limitations of liability, which may significantly limit any potential recovery, and exculpatory clauses, which may prevent the pursuit of any subrogated claims against the alarm company. However, it is sometimes possible to circumvent these restrictions, for example by arguing that the alarm company acted in a grossly negligent way. In the Georgia case of Peck v Rollins Protective Services (1988) Rollins installed burglar alarm equipment which was incompatible with Peck's home telephone system, so it was a virtual certainty that the system would not work. When Peck was burglarised, she claimed against Rollins alleging, amongst other things, gross negligence, and willful and wanton conduct. The court said that the facts did raise an issue of whether there had been conduct by Rollins which precluded the enforcement of the limitation of liability clause.

Also, in the more recent New York case of Abacus Federal Savings Bank v ADT Security Services (2012), two alarm systems installed by ADT and Diebold Incorporated failed to operate properly, and thieves stole millions of dollars. The installation and maintenance contracts for both companies limited their liability in all circumstances to $250. Both contracts required the bank to purchase insurance, but only the Diebold contract included a waiver of subrogation clause, whereby the bank agreed to look solely to its insurer for any theft losses. The bank alleged gross negligence based on the companies' failure to act on their knowledge that the systems were malfunctioning in the weeks prior to the theft. The court held that the gross negligence allegations defeated the contractual limitations of liability but not the waiver of subrogation; therefore, the bank could only continue its claim against ADT.

However, waiver of subrogation or other exculpatory clauses will not always be upheld. In Puro v. Neil Enterprises (2009), thieves stole jewelry and coins from an antiques mall. The security cameras were turned off at the time, so the thieves could not be identified. Before the plaintiffs signed the lease, the defendant landlord had made frequent references to the "state of the art" alarm system and "video cameras everywhere." This misrepresentation of the building's security features meant that the defendant could not rely on a clause stating that it would not be liable for any losses caused by, amongst other things, theft.

Another way of circumventing limitation of liability clauses in the US has been pursuing a claim against a non-contracting party, for example in situations where the alarm company has sub-contracted its obligation to respond to an alarm to a third party. In the Florida case Travelers Insurance Company v Securitylink (2008), a warehouse owner contracted with an alarm company, which in turn contracted a security firm – the defendant - to respond to alarms. In this case, the security firm was late to respond and, inexplicably, failed to notice the theft in progress after arrival. Because there was no contract between the warehouse owner and the security firm, there was no limitation of liability to apply.

In the UK, exculpatory or limitation of liability clauses are less likely to be an issue for insurers, as they often fall foul of the Unfair Contract Terms Act 1977, which contains a provision that any such terms are subject to an assessment of reasonableness.

In conclusion, whenever rare or unique items are damaged or destroyed, and there is no readily apparent primary target for a recovery, do not automatically conclude that there is no viable recovery action. Consideration should be given to potential secondary targets, including product manufacturers, architects, engineers, contractors, and security and alarm companies, whose actions may have ultimately allowed the loss to occur or exacerbated the damage.