



Protective Safeguards Endorsements

by James P. Nolan II

Abstract

Commercial property insurance policies may include a protective safeguards endorsement. This article addresses certain issues that may arise under the Protective Safeguards endorsement issued by Insurance Services Office, Inc. (ISO) as well as information to consider in handling claims in which the endorsement applies.

A protective safeguards endorsement generally requires the insured to keep a particular safeguard at the insured premises in working order. If a loss occurs because a protective safeguard was not operational, the policy may not provide coverage.

Although the Insurance Services Office, Inc. (ISO) Protective Safeguards endorsement is written to apply to various types of protective safeguards, this article will focus on automatic sprinkler systems.

Operative Language of the Endorsement

The ISO Protective Safeguards endorsement adds the following language to the Commercial Property Conditions Form:

1. As a condition of this insurance, you are required to maintain the protective devices or services listed in the Schedule above.

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2. The protective safeguards to which this endorsement applies are identified by the following symbols:

“P-1” Automatic Sprinkler System, including related supervisory services.

The endorsement also adds the following language to the Exclusions section of the Commercial Property Conditions Form:

We will not pay for loss or damages caused by or resulting from fire if, prior to the fire, you:

1. Knew of any suspension or impairment in any protective safeguard listed in the Schedule above and failed to notify us of that fact; or
2. Failed to maintain any protective safeguard listed in the Schedule above, and over which you had control, in complete working order.

If part of an Automatic Sprinkler System is shut off due to breakage, leakage, freezing conditions or opening of sprinkler heads, notification to us will not be necessary if you can restore full protection within forty-eight hours.

Main Aspects of the Endorsement

From the viewpoint of the insured business, endorsements are usually added to policies to provide additional coverage. The Protective Safeguards endorsement, however, does not provide any additional coverage. Instead, the endorsement adds an additional condition with which the insured must comply. If the insured does not comply with the condition, the exclusions then operate to eliminate fire coverage.

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Let's consider an example of a restaurant with an automatic sprinkler system. An operational sprinkler system is an effective safeguard that is designed to substantially mitigate the spread of fire. The insurer can afford to offer a lower rate for fire insurance based on the premise that the sprinkler system is fully operational. The insurer can endorse the policy to include a protective safeguards endorsement that identifies the sprinkler system. In return, the insured benefits from a reduced fire insurance premium due to the endorsement being added to the policy.

Problems arise when a sprinkler system is not operating properly and a fire loss occurs. A fire that occurs under these circumstances could result in severe damage. If the policy contains a protective safeguards endorsement, the potential consequences to both the insurer and the policyholder may be significant.

Loss Control Inspections

What if a loss control inspection reveals that a sprinkler system is not operational, yet the insurer does not take immediate steps to suspend fire insurance coverage until it is? This is the problem that the court considered in *Century Mut. Ins. Co. v. YCAW5, LLC*.¹ This case illustrates the insured's burden to satisfy the condition to maintain a sprinkler system, the exclusion for fire coverage if the insured fails to maintain the sprinkler system in accordance with the policy, and the effect of the

knowledge that the insurer gains through its loss control inspections prior to the fire.

The insured property in this case was a large warehouse with a small office at the front of the building. Outside the building were two water valves, each of which controlled water leading to the sprinkler system. Vandals broke into the building and started a fire in an area that was not covered by the sprinkler system because the valve for that portion of the building had been turned off. The insured was aware that the valve had been turned off prior to the fire. In addition, the insurer had learned during a loss control survey that it performed weeks before the fire occurred that the valve had been turned off so the sprinkler system may not be fully operational.

The Century Mutual policy included a protective safeguards endorsement that contained both a condition and an exclusion. The condition required that the insured “maintain” a fire-protective P-1 sprinkler system. The analysis in this case focused on the undefined word “maintain,” as set forth in the condition. The court found that this undefined term did not necessarily mean the system had to be “in good working order” on the date of loss, but merely that it needed to have been “installed” as of the policy inception date. (The condition was distinguished from the exclusion, which referred to maintaining the system “in good working order.”) The court found that the insured did not breach a policy condition by failing to keep the fire suppression system working beyond the policy inception.

The Century Mutual policy also included an exclusion that was applicable if the insured adopted one of two approaches:

- Knowing that the sprinkler system was suspended or impaired and failing to notify the insurer

- Failing to maintain any protective safeguard listed “in complete working order”

Note the important language used to qualify the word “maintain” in the exclusion as opposed to the condition.

The court found that the insurer had knowledge that was equal to that of the insured. The loss control inspector had noticed that a sprinkler valve was turned off. Yet, the insurer neither notified the insured and told it to correct the problem, nor canceled the policy until corrective action was taken. On this basis, the court found a jury issue regarding whether the insurer had in effect waived its right to enforce the exclusion.

This case illustrates the importance of information that the insurer obtains through its loss control inspectors when analyzing coverage issues pertaining to a protective safeguards endorsement. It also illustrates the different levels of proof for the insured to satisfy the policy condition compared with the insured’s requirements under the exclusion. As long as an automatic sprinkler system is installed as of the inception date of the policy, the insured will satisfy the condition of the endorsement. To avoid the impact of the exclusion, however, the insured must maintain the sprinkler system “in complete working order.”

Other Issues Following a Loss

Now, let’s assume that the insurer’s loss control inspector confirmed that the sprinkler system for the insured premises was fully operational at the time of the inspection. Later on, however, the system became impaired and a fire loss occurred.

The issue that would arise is whether the policyholder was aware that the sprinkler system was not operational before the fire. A related issue is whether an employee’s

“ A causation issue that may arise following a loss is whether the impaired protective safeguard either caused the loss or contributed to the extent of the loss ”

knowledge of the impairment of the protective safeguard may be imputed to the named insured for purposes of enforcing the exclusion.

The Policyholder’s Knowledge

When evidence shows that a policyholder had knowledge that its sprinkler system was not in complete working order before a fire loss occurred, a court may be expected to uphold the exclusion.² In one case, a court examined the application of a protective safeguards endorsement in a commercial policy after a restaurant failed to properly maintain a dry fire-suppression system near its frying equipment. The court determined that the portion of the endorsement that modified the commercial property conditions was not enforceable because the term “maintain” as used was ambiguous, as there were multiple interpretations of the term under those circumstances. However, the court enforced the portion of the endorsement that added an exclusion of coverage.

The exclusion provided that the automatic sprinkler system must be maintained “in complete working order.” Several letters had been sent by the dry fire-suppression

system’s manufacturer and service agency regarding the fact that the system was no longer supported. Under the court’s reasoning, this exclusion was clear and enforceable.

Imputed Knowledge

The issue of imputed knowledge was raised in *Commercial Union Ins. Co. v. Taylor*.³ The named insured’s owner was absent from the insured premises the day the sprinkler system began leaking. His nephew, an employee who worked as a clerk at the insured premises, turned off the system without telling the owner of the business. Subsequently, there was a fire. The court determined that the actions of the employee were not imputed to the owner, and therefore the exclusion did not apply.

In a similar situation, if a maintenance employee, on the other hand, has knowledge that a sprinkler system has been turned off, the maintenance employee’s knowledge may be imputed to the employer/policyholder, and the exclusion would be enforceable.⁴

Causation

A causation issue that may arise following a loss is whether the impaired protective safeguard either caused the loss or contributed to the extent of the loss. For example, suppose a protective safeguards endorsement for a restaurant policy specifies a hood fire-suppression system for the kitchen. If a fire originates in another part of the building and the investigation reveals that the operation of the hood fire-suppression system in the kitchen would not have affected the extent of the fire damage at all, it is questionable whether a court would enforce the exclusion under these circumstances.

Mortgagee’s Claim

The effect of a standard mortgage clause is to create a separate contract between the mortgagee named in the policy and the insurer. If the mortgagee is unaware that a protective safeguard identified in the

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endorsement is no longer operational and a loss occurs, the exclusion most likely will not be enforceable against the mortgagee named in the policy.

Information to Consider

When analyzing coverage issues that arise under a protective safeguards endorsement that identifies an automatic sprinkler system where a fire loss has occurred, the following should be considered:

- Application for insurance—Does the insurance application indicate that the building to be insured is equipped with an automatic sprinkler system?
- Underwriting file—Does the underwriting file reflect communications between the insured and the insurer about the effect of the automatic sprinkler system on the rate for fire insurance on the property? Were there discussions about adding a protective safeguards endorsement to the policy?
- Loss control inspection reports—Did the loss control representative verify whether the protective safeguard identified in the policy was fully operational at the time of inspection? Did the loss control representative or the insurer (specifically, someone from underwriting) send any follow-up correspondence to the insured or the agent concerning the protective safeguard identified in the policy?
- Complete information regarding why the protective safeguard was not in working order at the time of the loss.
- The origin of the loss, as well as its cause.
- The insurance agent's file—Did the agent explain to the insured that, based on the information in the insurance application, a protective safeguards endorsement would be added to the policy? Did the agent explain the effect of the endorsement to the insured?

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If the mortgagee is unaware that a protective safeguard identified in the endorsement is no longer operational and a loss occurs, the exclusion most likely will not be enforceable against the mortgagee”

- The insured's own maintenance records concerning the protective safeguard.
- Maintenance contracts and service records from any outside contractor that serviced the protective safeguard.

For most businesses, fire is the most significant insurable peril. When an insurer notifies its policyholder that a significant fire loss may not be covered under the exclusionary language of the protective safeguards endorsement, the relationship between the insurer and the policyholder may become contentious. The points raised in this article may be useful in both claims handling and communicating effectively with the insured and the agent regarding any potential problems with the protective safeguard that the insurer is aware of before a loss occurs. ■

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Endnotes

1. 2011 Ohio Misc. LEXIS 168 (Franklin County, Ohio C.P. Jan. 4, 2011).
2. See *French King Realty, Inc. v. Interstate Fire and Cas. Co.*, 948 N.E.2d 1244 (Mass. App. Ct. 2011).
3. *Commercial Union Ins. Co. v. Taylor*, 312 S.E.2d 177 (Ga. App. 1983).
4. *Chaucer Corporate Capital (No. 2) Ltd. v. Norman W. Paschall Company, Inc.*, 525 Fed. Appx. 895 (11th Cir. 2013).



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