MAXIMIZING RECOVERY OF DAMAGES

IN SUBROGATION/RECOVERY CLAIMS

By Mark T. Mullen

Insuring that recovery representatives and adjusters are maximizing damages for which recovery is sought by way of negotiation, arbitration, or trial is a several step process. All of us familiar with subrogation claims are well aware that almost every claim resolved will have a discount attached due to the liability dispute. Prior thereto, the parties usually come to either a figure or a range of potential recovery from which to start the process. Therefore, we certainly want to start with the maximum provable damage claim that we can legitimately advance under the law. The goal is to have our figure as the starting point for negotiation rather than the other side's lower figure.

I. EARLY RECOGNITION

The first step is early recognition in a particular file of subrogation potential. Understandably, due to the volume of claims adjusted, very few actually result in recovery on a percentage basis. Nevertheless, it is critical to separate the wheat from the chaff as early as possible. The recognition of subrogation potential early is critical to the investigation of liability issues and preservation of evidence. It is also important for damages.

While the company's obligations to adjust the loss and pay the claim are determined by the policy, it is important for all involved to understand that eventually we must convince an opposing claims adjuster, lawyer, or jury that the damages paid under the policy were actually sustained, not inflated, reasonable, and recoverable under the tort or contract law of the jurisdiction (which will differ from the policy).

A prime example is preserving as evidence not only the things that may have caused the fire - but also proof of damaged items. As always, there are competing interests, most notably, getting the insured back into his or her home or business and also maximizing salvage. Keeping some actual physical samples of damaged items, numerous photographs, and extensive backup documentation is essential. Early recognition is the key that opens the door to the second step — documenting the damage claim.

II. DOCUMENTING THE DAMAGE CLAIM

While the adjustment process of the insurance claim is proceeding, a parallel process for the future recovery claim must also be undertaken and kept in mind whenever possible. For the most part, the two will essentially be the same. There are some subtle differences that can be tracked during this process that will help maximize recovery.

For damaged personal or business property, determining original cost and date of acquisition for larger, expensive items is always advisable. Detailed inventory lists taken room by room, while a pain to obtain, are unbelievably helpful. Having the insured provide original costs, estimated values, and dates of acquisition shortly after the loss, while memories are fresher, is very helpful. An independent assessment (by the adjuster) of the actual cash value ***and*** replacement cost can help immeasurably later on.

With respect to additional living expense and extra expense claims, obtaining backup documentation in the file is a must. If it is impractical to get back-up documentation for everything, the claim file obviously should have an explanation of the payment amount and the reason for the payment, including a computation, so that counsel can figure out how best to present that claim in a recovery effort.

Loss of income or business interruption claims are probably the most difficult. As a result, all of the documentation upon which the claim is considered must be in the file - even if the insured claims the material is sensitive or privileged. Remember, most policies require the insured to cooperate and provide the information and an appropriate confidentiality agreement can be obtained from counsel in the exceptional case. It is much easier if the documents and information are in the file rather than having to chase an insured who already, in his mind, has been inconvenienced by the catastrophe and by you requiring him to prove the claim. The insureds really do not want us knocking on the door and asking for more information.

In many cases, an independent accounting firm is retained on the adjustment of the business interruption claim under the policy. Such reports are indispensable in proving loss of income or business interruption claims because they usually contain all of the backup documentation and explain exactly how the claim was computed and disputed if the insured has presented a claim by its accountants. If the business interruption claim has a cutoff date, advise the insured that it will need the backup itself to prove its uninsured claim if the insured anticipates attempting to recover the claims not covered under the policy because of an arbitrary cutoff date.

Always be careful of "negotiated claim" items. An obvious reality of your business is negotiation of certain disputed items or entire claims. If that is good for the company, it should be done. Please be sensitive to what it does to your recovery. For example, assume documents supporting a claim of $5,000 for certain items burned in the closet during a fire and the insured has submitted a claim for $15,000, and you decide to pay $8,000. We now must try to recover $8,000 with backup documentation from our insurance company client documenting only $5,000 in damages. Some of these issues are unavoidable, but others can be

softened prior to the determination of payment being made. If appropriate, the file can reflect that additional documents were submitted by the insured or something may have been missed originally. If it is truly a negotiated claim, then simply leave it at that and do not ever attempt to make it look as though something else was submitted or considered if in fact that did not take place.

It may be helpful to remember that almost any comment or item in a claim file that deals with damage is subject to discovery if suit is filed. Under the broad discovery rules in the federal courts and most states, there are very few arguments that can legitimately be advanced to keep documents or comments relating to the overstatement of a claim or an item in a claim from being turned over. Comments such as "the insured's claim for business interruption is completely fabricated" or "is ridiculous" are not particularly helpful when trying to negotiate the amount recoverable under a subrogation theory of recovery if some payment is eventually made. Also, in cases where subrogation possibilities are good, avoid any reference that a payment may be made to the insured because it is "going to be recovered anyway." The information certainly can be conveyed in a less drastic fashion.

III. SIFTING

After the insurance claim has been documented and paid, the sifting stage takes place. This stage is where the recovery personnel or counsel take a hard look at what has been paid under the policy and what is recoverable in the jurisdiction whose damage law will apply.

The key point to remember is that the two are not identical. Actual cash value and replacement cost are insurance terms usually defined in the policy for payment of personal or business property. Most jurisdictions allow recovery of market value or fair market value for personal property and are usually defined as what a willing buyer will pay a willing seller for a

particular item. For new items and antiques, the market value may be the replacement cost; for older items the market value will probably be close to the actual cash value which takes age, condition, and depreciation into account.

For real property, the law of most jurisdictions only allows recovery of the diminution in market value while insurance policies generally pay either replacement cost, i.e., what it would cost to rebuild the building with like materials; or actual cash value which essentially is what it cost to put up the structure when it was put up. As examples, a magnificent old stone home in a depressed neighborhood or an old factory in a depressed industrial park present classic problems. If insured at replacement cost and actually repaired or replaced following a devastating fire, the losses at replacement cost can easily be in the millions of dollars. The diminution in market value of those same structures may only be in the hundreds of thousands of dollars.

The sifting process also should include the recognition of issues such as those set out above and creative but legitimate arguments in an effort to maximize damages. Several examples involve arguing that a particular structure is unique and therefore replacement cost rather than market value should be the measure of damage [Trinity Church v. John Hancock Mutual Life Ins. Co., 502 N.E.2d 532 (Mass. 1987)]; mandatory code upgrades should be included even though not in the original structure because defendant's actions resulted in the increased cost [Pelvso v. Singer General Precision, Inc., 365 N.E.2d 390 (Ill. App. 1977)]; household items should be valued at replacement cost rather than market value because they have unique value to the owner[1] and what they would bring in a garage sale is not a true measure

[1] It is helpful to have the homeowner prepare or participate in the valuation of household items so that they feel comfortable at trial testifying as to those values.

of the loss to the plaintiff [Lynch v. Bridges & Co., Inc., 678 A.2d 414 (Pa. Super. 1996)]. Not all of these arguments will work, but the process must be undertaken to identify potential problems and advance sound arguments for recovering the amount paid if at all possible.

The sifting process must be performed in any case where trial is possible. An essential element of a recovery case, regardless of the theory of liability, is proof of damages. Although rare, cases can and have been dismissed because the plaintiff did not properly establish the provable damages required by the law of that jurisdiction. As an example, solely using "replacement cost" figures could result in a verdict for the defendant prior to it having put on its case, because the plaintiff has not met its burden of proof in the first instance. In other states, such as New York, the plaintiff can use replacement cost and the burden shifts to the defendant to establish a different, more appropriate measure of damage.

Carefully and promptly sifting through the damages to make sure the insurance adjustment figures have been converted to those recoverable under the law will enable you to start the negotiation process at the best figure possible and help you resist arguments that your damages contain "fat" that must be trimmed **before** the opposing adjuster or lawyer discusses an appropriate discount for liability. You want to be prepared to negotiate from your number rather than the other side's number or a compromise figure whenever possible. You can only do so when you are prepared to answer and explain the challenges to your damages.

IV. PROOF OF DAMAGES

Daniel Harrington, a senior member in the Philadelphia Subrogation Office, prepared an excellent article entitled "*Proof of Damage in Subrogation Actions: Problems and Solutions*" that was published in the 1995 Property Insurance Seminar handout. Dan's article is available upon request and sets forth exactly how damages in several relevant jurisdictions must

be established at trial in a subrogation action. One update of note is a recent Pennsylvania Commonwealth Court decision where the Court defined the permanency of an injury to real property "in terms of whether or not the cost of repair would be unfair or inappropriate under the circumstances." The cost to repair must not "disproportionately" exceed the diminution in market value. Duquesne Light Co. v. Woodland Hills School Dist., 700 A.2d 1038 (Pa. Cmmwlth. 1997).

When required to do so at trial, actually proving damages can be a very tedious task if the damages are not stipulated to or agreed upon by the parties prior to trial. Due to the relevant rules of evidence and the sheer volume of documents usually present in a detailed adjustment, making sure that all of the documents are properly authenticated and admitted into evidence can be an exhaustive process. In addition, due to hearsay concerns and the rules relating to expert testimony, builders and other damage "experts" retained by the adjuster may have to testify rather than just the property adjuster.

Statements of Loss, Subrogation and/or Loan Receipts, and Proofs of Loss are critical documents and should be obtained in every case. Having a convenient and detailed breakdown of exactly what was paid is a very valuable tool in going through the sifting process and moving to the stage of actually putting together and proving the damage claim.

Finally, we can never lose sight of the fact that while the other side is attempting to "trim the fat" off our claims, we should not give them any help; the counter balance to presenting a subrogation claim is the old adage about violating the pig rule. Hogs get fat; pigs get slaughtered. There is nothing worse than having a solid liability case go in during direct and then have witnesses lose credibility because the damages were inflated, overstated, or fabricated. Early recognition, proper documentation, and sifting will lead to a damage figure that is the

maximum supportable amount possible and should withstand your opponent's trimming shears and the slaughterhouse of cross-examination.

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