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2007 ROCKY MOUNTAIN SUBROGATION SEMINAR

WEDNESDAY, AUGUST 22, 2007
COORS FIELD
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DENVER, CO

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2007 Rocky Mountain Subrogation Seminar

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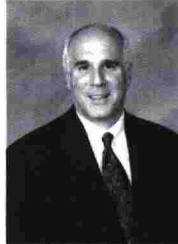

Brad W. Breslau

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Chair, Subrogation & Recovery, Rocky Mountain Regional Offices
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AREAS OF EXPERIENCE

- General Litigation
- Property Subrogation
- Real Estate Litigation
- Subrogation & Recovery

EDUCATION

- J.D., University of Denver College of Law, 1979
- B.S., University of Colorado at Boulder, 1976

MEMBERSHIPS

- American Bar Association
- Colorado Bar Association – Committee Member for Litigation Section Council
- Colorado Defense Lawyers Association
- Defense Research Institute
- National Association of Subrogation Professionals - Colorado Chapter, Board of Directors

Brad W. Breslau joined the firm in June 2003 and is the Office Managing Partner of the Denver, Colorado office and Chair of the Subrogation & Recovery Department's Rocky Mountain Regional Offices. Brad practices with the Subrogation and Recovery Practice Group, concentrating in complex litigation, with an emphasis on insurance, subrogation and recovery. Brad also has an active litigation practice in the areas of commercial, real estate and oil and gas litigation. Prior to joining the firm, Brad was the founding and managing partner of, and practiced with, Grund & Breslau, P.C.

Brad has served as an arbitrator, expert witness and court-appointed mediator on numerous occasions. He has also lectured business professionals on numerous issues involving civil liability and has lectured attorneys and insurance professionals on the subjects of insurance, construction, employment discrimination and condominium litigation in Colorado.

In 1976, Brad received his bachelor of science degree from the University of Colorado at Boulder. He earned his law degree from the University of Denver College of Law in 1979.

Brad is a member of the American, Colorado, and Denver bar associations, the Colorado Defense Lawyers Association and Defense Research Institute. He is admitted to practice in Colorado state and federal courts, as well as before the United States Court of Appeals for the Tenth Circuit.

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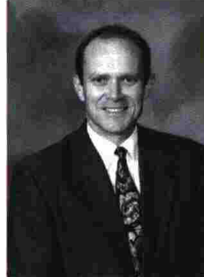

Thomas M. Dunford

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AREAS OF EXPERIENCE

- Property Subrogation
- Subrogation & Recovery

EDUCATION

- J.D., University of Minnesota Law School, 1988
- B.A., Brigham Young University, 1985

MEMBERSHIPS

- Colorado State Bar Association
- Washington State Bar Association
- Idaho State Bar Association

Tom Dunford joined Cozen O'Connor in July 1991 and practiced in the Seattle office for more than 12 years. He relocated to the Denver office in August 2003, where he concentrates his practice in subrogation for property insurers. Tom pursues all types of property damage claims, including those based on product defects, product failure, structure failure, fire loss and tort liability.

Tom received his Bachelor of Arts degree from Brigham Young University in 1985 and earned his law degree, cum laude, at the University of Minnesota Law School in 1988. He was admitted to practice in Washington in 1988, Idaho in 1994, and Colorado in 2000. He is also admitted in the federal courts in those states.

Tom is a member of the Colorado, Washington and Idaho State bar associations. He is also a member of Phi Kappa Phi.

Tom coaches youth league basketball and is actively involved with the Boy Scouts of America.

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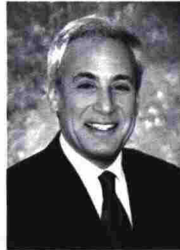

Elliott R. Feldman

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AREAS OF EXPERIENCE

- Subrogation & Recovery

EDUCATION

- J.D., Temple University School of Law, *cum laude*, 1980
- B.A., Temple University, *summa cum laude*, 1975

MEMBERSHIPS

- Philadelphia Bar Association
- Pennsylvania Bar Association
- American Bar Association
- Philadelphia Trial Lawyers Association
- Pennsylvania Trial Lawyers Association
- Association of Trial Lawyers of America
- National Association of Subrogation Professionals
- Phi Beta Kappa

Elliott R. Feldman joined the firm in 1982 and is Chair of Cozen O'Connor's National and International Subrogation and Recovery Department. He also serves on the Management Committee of the firm.

Elliott concentrates his practice in the prosecution of property damage subrogation claims. He has litigated and tried many substantial subrogation matters, and has secured numerous six-figure and multimillion-dollar recoveries for his insurance and commercial clients.

A frequent lecturer, Elliott has lectured on a broad range of topics pertaining to the subrogation practice area before numerous insurance industry groups, including the National Association of Subrogation Professionals, the Property Loss Research Bureau, the Loss Executives Association, the Property Claim Services Division of ISO, the National Association of Independent Insurance Adjusters, the New England Claims Executives Association, and many other property and recovery professional associations. He has also served as a guest lecturer at the Wharton School of the University of Pennsylvania Graduate Program on Negotiation and at the Temple University School of Law's Trial Advocacy Program.

Elliott has authored a number of articles and papers for insurance, legal and business publications, including "Investigating Insurance Claims, Section on Spoliation of Evidence" and "Insuring Real Property," both published by *Matthew Bender & Company, Inc.* His three-part series, titled "Ethics and Property Damage Subrogation, Parts I, II and III," was featured in the April, May and June 2003 issues of *Claims Magazine*, and his article on "Subrogation in the Eye of the Hurricane" appeared in its November 2004 issue. Elliott's article on disaster planning, titled "Is Your Business Prepared for the Worst?" was featured in the April 2002 issue of the *Journal of Accountancy*, and his article on how the subrogation process can help businesses improve their bottom line, titled "Work Like an Insurance Company to Save Money" was featured in its October 2004 issue.

Elliott serves as president of the National Association of Subrogation Professionals (NASP) and is on its board of directors and executive committee. He chaired the NASP 2003 annual conference and was the co-author of the chapter on products liability for NASP's Certified Subrogation Recovery Professional examination.

Elliott is a member of the Pennsylvania, Philadelphia and American bar associations and is a member of Phi Beta Kappa. He was selected a 2005, 2006 and 2007 "Pennsylvania Super Lawyer" by his peers, appearing in *Philadelphia Magazine* and *Pennsylvania Super Lawyers.*

Elliott is admitted to practice in Pennsylvania and before the U.S. District Court for the Eastern District of Pennsylvania, and the Districts of Arizona, Michigan and Connecticut; the U.S. Court of Appeals for the First, Second, Third and Ninth Circuits; and the U.S. Supreme Court.

Elliott received his bachelor of arts degree, *summa cum laude,* in 1975 from Temple University and, after doing graduate work at Harvard University, earned his law degree, *cum laude,* from Temple University School of Law in 1980.

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Sarah Earle Killeen

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Sarah Earle Killeen joined the firm in May 2004 as an Associate in the Subrogation and Recovery Department of the Denver office.

Sarah received her bachelor of arts degree from Barnard College, Columbia University in 1996, and her law degree from the University of Denver College of Law in 2000, where she was an editor of the University of Denver Law Review and a regional semifinalist of the ATLA Trial Team.

Sarah is admitted to practice in Colorado and California.

AREAS OF EXPERIENCE

- Arson and Fraud
- Complex Torts & Products Liability
- Construction Defect
- Construction Law & Litigation
- Products Liability
- Property Subrogation
- Subrogation & Recovery

EDUCATION

- J.D., University of Denver College of Law, 2000
- B.A., Barnard College, Columbia University, 1996

BAR ADMISSIONS

- Colorado
- California

COURT ADMISSIONS

- California Superior Court
- Colorado Supreme Court
- U.S. Bankruptcy Court -- Colorado
- U.S. District Court -- Colorado

MEMBERSHIPS

- California Bar Association
- Colorado Bar Association
- Denver Bar Association

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Richard R. Rardin

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AREAS OF EXPERIENCE

- Construction Defect
- Products Liability
- Property Subrogation & Recovery
- Subrogation & Recovery
- Worker's Compensation Subrogation & Recovery

EDUCATION

- J.D., University of Wyoming College of Law, 1991
- B.S., University of Wyoming, 1987

MEMBERSHIPS

- American Bar Association
- Colorado Bar Association
- Wyoming Bar Association
- Denver Bar Association

Richard R. Rardin joined Cozen O'Connor's Denver office in June 2003 and is a Member of the firm's Subrogation & Recovery Department. Prior to joining Cozen O'Connor, Richard was an associate with Grund & Breslau in Denver. Richard has also served as an assistant city attorney with the city and county of Denver, as well as a deputy district attorney with the 13th Judicial District in Sterling, Colorado, and deputy prosecuting county attorney in Rock Springs, Sweetwater County, Wyoming, in the 3rd Judicial District.

Richard received his bachelor of science degree in 1987 and his law degree in 1991 from the University of Wyoming. He is admitted to practice in Wyoming and Colorado, as well as before all state and federal district courts in those respective states.

Richard is a member of the American, Colorado, Wyoming and Denver bar associations.

EXPERIENCE SUMMARY:

Mr. Tarr is a Construction Consultant specializing in cost estimating, contract administration, and thermal and moisture protection. Mr. Tarr received his National Higher Diploma for Civil Engineering in 1990 from Natal Technikon, Durban, South Africa, and is a Certified Professional Estimator. His initial experience was gained with a large general contracting company, Murray and Roberts, as an assistant to a project manager on various projects. He was responsible for checking cost estimates, quantities, subcontract negotiations, subcontractor scheduling, project scheduling, contract documentation, administration and on-site supervision. These projects varied from multi-phased remedial repairs and upgrades to new construction of oil refineries and smelter plants, to shopping malls and high-rise buildings.

Mr. Tarr was transferred to a subsidiary company, Amalgamated Construction, and promoted to Project Manager. His duties included project management, subcontract evaluation, negotiation and scheduling, project cost analysis, on-site supervision and negotiations with architect, engineer and clients on a luxury custom housing project.

As Chief Estimator with NPW Contracting, he was responsible for quantity takeoffs, bid solicitations, bid preparation and bidding, project monitoring and management. His experience in expansion control, thermal insulation and moisture protection was gained on a variety of projects including residential, commercial, educational, and institutional buildings, as well as, state and federal highway projects.

As Senior Estimator with ***Madsen, Kneppers & Associates, Inc.***, Mr. Tarr has been involved in the evaluation of a wide variety of property loss claims caused by explosions, fires, snowstorms, tornadoes, lightning, hail, flooding, water pipe freezes and leaks. These claims have included single and multifamily residential, commercial, religious, educational, institutional, high-rise and historic buildings. His tasks have included damage surveys and inspections, preparation of conceptual and detailed estimates, audits of contractor repair and replacement costs, property appraisal and clerk of the works services. Mr. Tarr has also provided estimating services and expert testimony for construction defect cases involving single-family residences, multi-family residences and educational facilities.

WORK HISTORY:

2005 - Present	**Regional Manager** - *Madsen, Kneppers & Associates, Inc.*, Aurora, Colorado
1999 - Present	**Senior Estimator/Consultant** - *Madsen, Kneppers & Associates, Inc.*, Aurora, Colorado
1996 - 1999	**Estimator/Consultant** - *Madsen, Kneppers & Associates, Inc.*, Aurora, Colorado
1994 - 1996	**Chief Estimator** - NPW Contracting, Inc., Denver, Colorado
1993 - 1994	**Project Manager** - Amalgamated Construction, Durban, South Africa
1990 - 1993	**Assistant Project Manager** - Murray and Roberts Construction, Durban, South Africa

EDUCATION:

National Higher Diploma - Civil Engineering, Natal Technikon, Durban, South Africa, 1990
National Diploma - Civil Engineering, Natal Technikon, Durban, South Africa, 1989

PROFESSIONAL CERTIFICATIONS AND SOCIETIES:

Certified Professional Estimator, American Society of Professional Estimators

II.

World Trade Center Litigation Update

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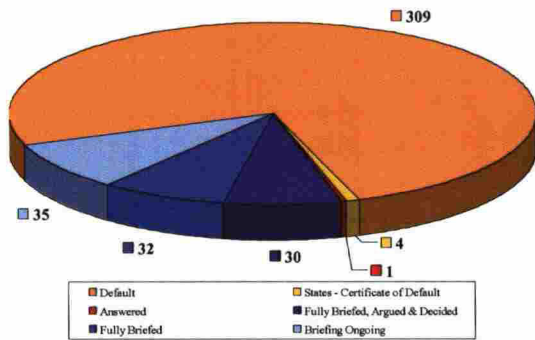
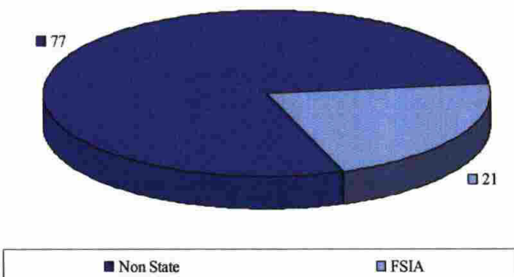
411 Defendants



98 Defendants which Appeared



DEFENDANTS IN DEFAULT

313 defendants are now in default, including:

- The foreign states of Iran, Syria, Sudan and Iraq, all of which have been designated as State Sponsors of Terrorism; and
- 199 defendants who are Executive Order 13224 designees or designated Foreign Terrorist Organizations.

THE NOTICES OF SUIT

English Version
International Herald Tribune, USA Today

THE NOTICES OF SUIT

إلى المدعى عليهم المذكورين والمدرجة أسمائهم أدناه:

Arabic Version – Al Quds Al Arabi Newspaper

ASSETS AVAILABLE TO SATISFY DEFAULT JUDGEMENTS

- Under the applicable statutes and regulations, **the Treasury Department is required to freeze any assets** within the United States or a foreign branch of U.S. banking institution, belonging to designated State Sponsors of Terrorism, Foreign Terrorist Organizations, or Executive Order 13224 designees.
- Pursuant to §202 of the **Terrorism Risk Insurance Act (TRIA),** frozen assets belonging to such designated parties are available to satisfy judgments held by victims of terrorism against those designees.

FROZEN ASSETS BELONGING TO DEFAULTING DEFENDANTS

- The United States government has frozen the following assets belonging to defendants who are now in default.
  - $60,500,000 in **Sudanese** assets;
  - $82,210,000 in **Iranian** assets;
  - $58,000,000 in **Syrian** assets;
  - $100,000,000 in aggregate assets belonging to Executive Order 13224 designees and/or **designated foreign terrorist organizations**;
  - Diplomatic pressure, time and other factors could expand pool of assets available well beyond those frozen to-date.

TERRORIST ASSETS REPORT

Calendar Year 2004
Thirteenth Annual Report to the Congress
on
Assets in the United States
of Terrorist Countries
and International Terrorism Program
Designees

Office of Foreign Assets Control
U.S. Department of the Treasury

FOCUS OF ARGUMENTS TO 2ND CIRCUIT

- The district court erred in deciding the Motion to Dismiss of the Kingdom of Saudi Arabia without considering plaintiffs' attribution theories
- The sponsorship of a terrorist organization is not a discretionary function
- The district court erred in holding that criminal conduct can never qualify as commercial activity under the FSIA
- The district court erred in holding that the plaintiffs were required to come forward with particularized facts or evidence to substantiate their allegations against Princes Sultan and Turki prior to discovery

ATTRIBUTION THEORIES

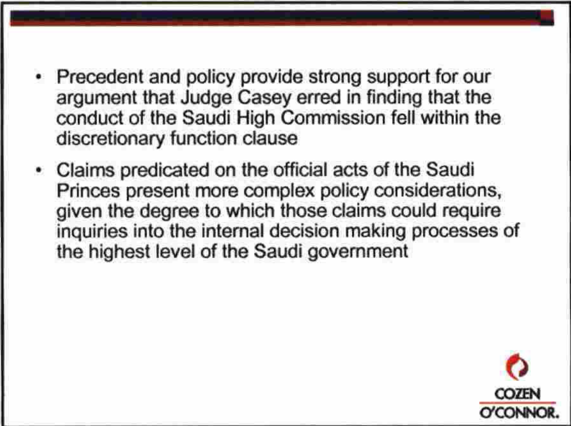
- Attribution arguments are predicated upon well established standards, including prior decisions of the Supreme Court and 2nd Circuit, none of which were addressed by Judge Casey in his decision
  - Supreme Court has held that the presumption of juridical independence must be disregarded: (1) where "internationally recognized equitable principals mandate attribution to avoid injustice;" or (2) where "the corporate entity is so extensively controlled by its owner that a relationship of principal and agent is created"
  - Applying those standards, the 2nd Circuit has held that the acts of a State's 'alter ego' may be attributable to the State in determining whether jurisdiction exists under the FSIA

- Judge Casey did not analyze our claims against the Kingdom in light of these binding decisions, instead summarily casting aside our attribution theories
  - "Rather than pleading specific facts showing that the Kingdom caused the plaintiffs' injuries, the Federal Plaintiffs focus predominantly on the charities' actions."

DISCRETIONARY FUNCTION CLAUSE

- Judge Casey ruled that the discretionary function clause bars our claims against the Saudi High Commission and Saudi Princes
  - In dismissing our claims against the Saudi High Commission, Judge Casey held:

    SHC's alleged misuse of funds and/or inadequate record-keeping - ***even if it resulted in the funds going to terrorists*** - was the result of a discretionary function and cannot be the basis for overcoming SHC's immunity



Precedent and policy provide strong support for our argument that Judge Casey erred in finding that the conduct of the Saudi High Commission fell within the discretionary function clause
Claims predicated on the official acts of the Saudi Princes present more complex policy considerations, given the degree to which those claims could require inquiries into the internal decision making processes of the highest level of the Saudi government
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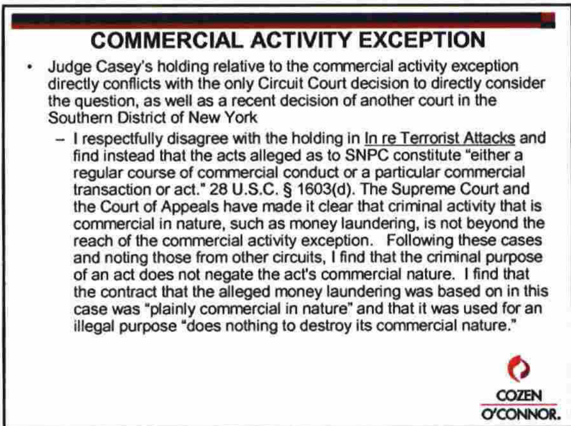

COMMERCIAL ACTIVITY EXCEPTION
Judge Casey's holding relative to the commercial activity exception directly conflicts with the only Circuit Court decision to directly consider the question, as well as a recent decision of another court in the Southern District of New York
– I respectfully disagree with the holding in In re Terrorist Attacks and find instead that the acts alleged as to SNPC constitute "either a regular course of commercial conduct or a particular commercial transaction or act." 28 U.S.C. § 1603(d). The Supreme Court and the Court of Appeals have made it clear that criminal activity that is commercial in nature, such as money laundering, is not beyond the reach of the commercial activity exception. Following these cases and noting those from other circuits, I find that the criminal purpose of an act does not negate the act's commercial nature. I find that the contract that the alleged money laundering was based on in this case was "plainly commercial in nature" and that it was used for an illegal purpose "does nothing to destroy its commercial nature."
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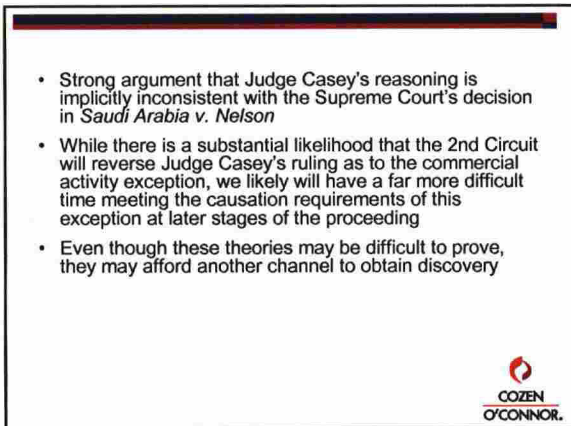

Strong argument that Judge Casey's reasoning is implicitly inconsistent with the Supreme Court's decision in Saudi Arabia v. Nelson
While there is a substantial likelihood that the 2nd Circuit will reverse Judge Casey's ruling as to the commercial activity exception, we likely will have a far more difficult time meeting the causation requirements of this exception at later stages of the proceeding
Even though these theories may be difficult to prove, they may afford another channel to obtain discovery
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IMPROPER PLEADING AND EVIDENTIARY BURDEN IMPOSED BY DISTRICT COURT

- Judge Casey held that plaintiffs failed to state claims against Princes Sultan and Turki under the tortious activity exception, reasoning that plaintiffs had failed to present "evidence" or "specific facts" in support of the allegations of knowledge and intent
- We have argued that a district court may not require a plaintiff to substantiate its allegations prior to discovery
- The decisions of the 2nd Circuit addressing the burdens in an FSIA case are enigmatic at best, and we have invited the 2nd Circuit to clarify this important area of the law
- Important to obtain clarification of this issue for claims against other sovereign defendants

PROCEDURAL STATUS OF CASE AND ANTICIPATED COURSE OF PROCEEDINGS IN EVENT OF REVERSAL OF DISMISSAL OF KINGDOM

- Two essential predicates for claims against Saudi Arabia based on conduct of its charities
  - The Kingdom controlled the charities
  - The charities committed a non-discretionary tort by knowingly supporting al Qaida
- Charities alleged to operate under Kingdom's control include: MWL, IIRO, WAMY, al Haramain, Saudi High Commission, Saudi Joint Relief Committee, Rabita Trust, Saudi Red Crescent

ANTICIPATED SCOPE OF REMAND RELATIVE TO ISSUE OF CONTROL

- The Kingdom of Saudi Arabia did not contest the factual allegations regarding its control over the charities in question
  - Waiver argument
- Assuming Kingdom did not waive its right to contest the allegations of control, and chooses to challenge its control over the charities on remand, Judge Casey will be required to address that issue
- Judge Casey has implicitly acknowledged that plaintiffs are entitled to discovery on the issue of control based on the facts and evidence presented to the Court thus far

CHARACTER OF EVIDENCE PRESENTLY AVAILABLE TO DEMONSTRATE CONTROL

- A number of the charities in question affirmatively represented to the Court that they were controlled by the Kingdom of Saudi Arabia
  - SHC asserted that its actions "properly are viewed as acts of [the Kingdom of Saudi Arabia]"
  - Saudi Joint Relief Committee and Saudi Red Crescent submitted affidavits and evidence to establish that they operated under the control of the Kingdom, and were therefore entitled to be treated as political subdivisions of the Saudi government
  - IIRO and MWL each raised as an affirmative defense their status as agencies and instrumentalities of the Kingdom
- Compelling evidence collected since filing of suit, through independent investigations and discovery process

OVERVIEW OF DISCOVERY IN THE 9-11 LITIGATION

- **Discovery is Proceeding Against Numerous Defendants**
- **Discovery allows Plaintiffs to Continue to Develop Case Against the Kingdom of Saudi Arabia during the appeal**
- **Examples of Documents Obtained from Defendants and Significance of Those Documents**
- **Principal Arguments Raised by Defendants to Avoid Turning Over Documents**
- **Plaintiffs' Strategy to Present to these Issues to Court for Resolution**
- **Discovery Disputes Presented to the Court Thus Far, And in the Near Future**
- **Defendants' Discovery to Plaintiffs and Responses Thereto**
- **On-Going Discovery (Letters Rogatory, Other Defendants)**

DISCOVERY IN THE 9-11 LITIGATION

Discovery is Proceeding Against a Number of Defendants:

- Muslim World League ("MWL")
- International Islamic Relief Organization ("IIRO")
- Rabita Trust
- Wael Jelaiden
- Jamal Barzinji
- Al Haramain Islamic Foundation (USA)
- Saudi Binladen Group
- National Commercial Bank

DISCOVERY – DEVELOPING THE CASE AGAINST THE KINGDOM

- Plaintiffs continue to develop the case against the Kingdom of Saudi Arabia while the appeal is pending, by targeting the following defendants in discovery:
- Muslim World League
  - Founded in 1962 by the Kingdom of Saudi Arabia, the MWL is among the world's largest Islamic charitable organizations
  - Alleged to have provided material and financial support to al Qaida
  - MWL has asserted it is an agency of the Kingdom.
- International Islamic Relief Organization
  - Subsidiary body of the MWL with offices around the globe
  - IIRO has asserted it is an agency of the Kingdom

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DISCOVERY – DEVELOPING THE CASE AGAINST THE KINGDOM

- Rabita Trust
  - Subsidiary body of the MWL based out of Pakistan; shares common officers with the MWL
  - After 9-11, U.S. Government designated Rabita as a Specially Designated Global Terrorist pursuant to Executive Order 13224
- Wael Jelaiden
  - A Saudi citizen, an associate of Bin Laden, and one of the founding members of al Qaida
  - Served as officer of Saudi Red Crescent, Saudi Joint Relief Committee and several other charities
  - In February 2002, Jelaiden was appointed to the Board of Trustees of Rabita Trust and served as its director general
  - After 9-11, U.S. Government designated Jelaiden as a Specially Designated Global Terrorist pursuant to Executive Order 13224

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DISCOVERY -- OTHER DEFENDANTS

Al Haramain Islamic Foundation (USA)

- United States-based operations of the Saudi charity headquartered in the Kingdom
- According to Al Haramain's director general, Sheikh Aqeel al Aqeel, the charity's operations are under the control and direction of the Kingdom
- Many of Al Haramain's branch offices throughout the globe, including the U.S. branch, have been designated as Specially Designated Global Terrorist Entities pursuant to Executive Order 13224

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DISCOVERY -- OTHER DEFENDANTS

National Commercial Bank

- Saudi Bank with billions of dollars in assets
- Kingdom took a controlling interest in NCB in 1999
- NCB alleged to have served as one of al Qaida's preferred banks for many years, maintaining accounts for many of the charity defendants that operate within al Qaida's infrastructure, including the IIRO, MWL, WAMY, al Haramain, among others

DECISIONS ON MOTIONS TO DISMISS

- Judge Casey has now issued decisions on 21 Motions to Dismiss.
- Judge Casey has granted the Motions to Dismiss of the following defendants:
  - Kingdom of Saudi Arabia; Prince Sultan, Prince Turki, Prince Salman, Prince Naif and Prince Mohamad; the Saudi High Commission; Arab Bank; Taha Al-Awani, Muhammad Ashraf, M. Omar Ashraf, Yaqub Mirza and Iqbal Unus; and Mar-Jac Poultry.

DECISIONS ON MOTIONS TO DISMISS

- Judge Casey has denied the Motion to Dismiss of the following defendants:
  - Rabita Trust, Wa'el Jalaidan, the International Islamic Relief Organization (IIRO), National Commercial Bank, the SAAR Network, Tarik Hamdi, Abdulrahman Alamoudi, Jamal Barzinji, the Saudi Binladin Group and individual Bin Laden family members..

Barzinji

IIRO

Alamoudi

DENIED MOTIONS WHICH SIGNIFICANTLY IMPACT THE KINGDOM

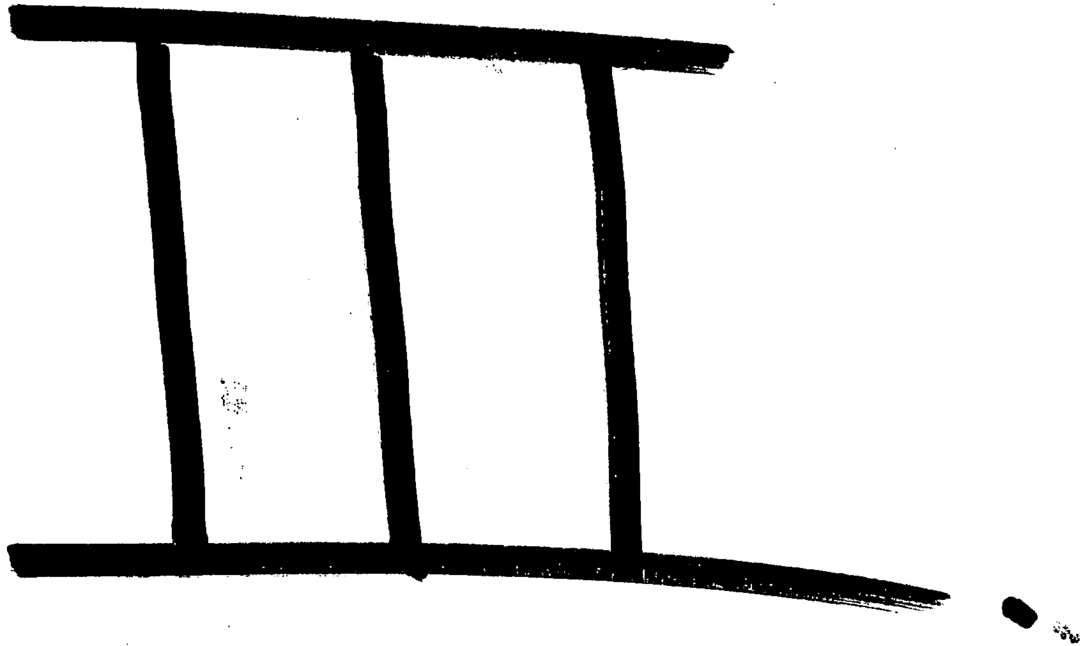
- The claims against the following defendants, whose motions have been denied, present strong opportunities to press our claims against the Kingdom of Saudi Arabia:
  - International Islamic Relief Organization (IIRO)
  - Rabita Trust
  - Wa'el Julaidan
  - National Commercial Bank

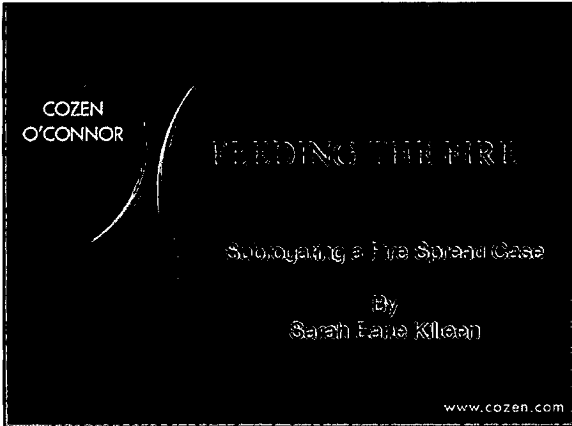
Measure Of Recovery

1. Traditional Concepts Of Recovery
2. Recovery Under The Anti-Terrorism Act (ATA)
   a. Direct Cause of Action
   b. Applicable Standard of Proof
      (i) injury to business or property
      (ii) analogous to recovery under the Clayton Act or RICO
      (iii) actual cash value v. replacement cost considerations

Elements Of The Claims For Damages

1. Indemnity Payments (Total Of All Claims Paid) (Property, BI, EE, ALE)
2. Claim Adjustment Expenses (Extraordinary, Accountants, Other Outside Consultants)
3. Claim Legal Expenses

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FEEDING THE FIRE
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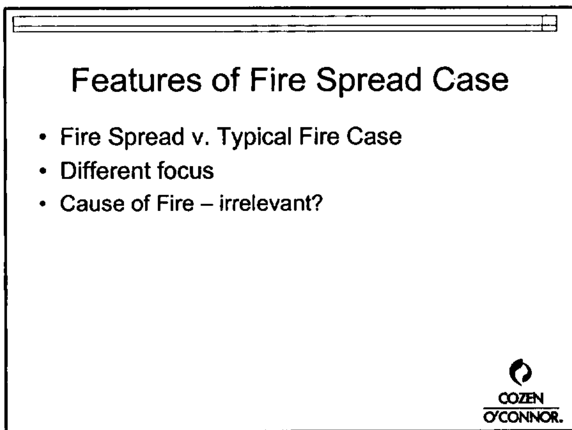
Features of Fire Spread Case
• Fire Spread v. Typical Fire Case
• Different focus
• Cause of Fire – irrelevant?
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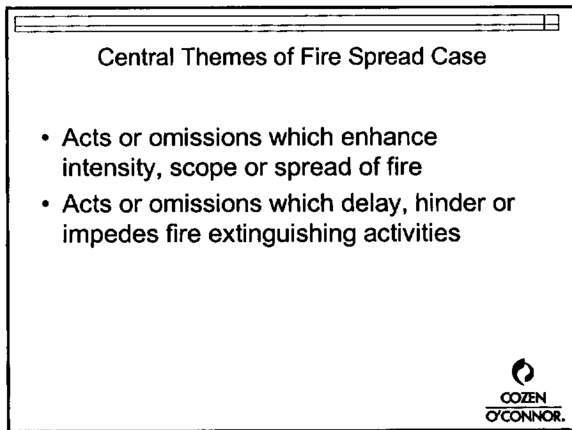
Central Themes of Fire Spread Case
• Acts or omissions which enhance intensity, scope or spread of fire
• Acts or omissions which delay, hinder or impedes fire extinguishing activities
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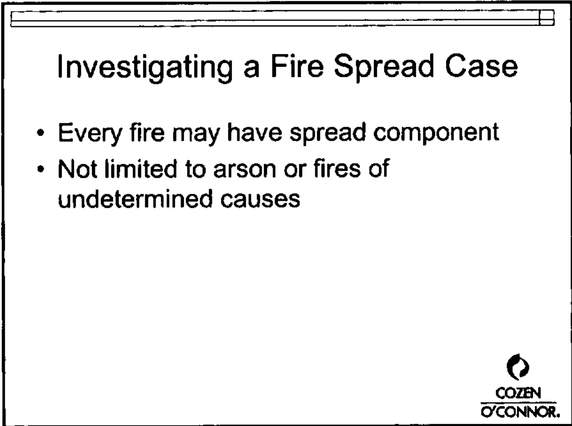
Investigating a Fire Spread Case
• Every fire may have spread component
• Not limited to arson or fires of undetermined causes
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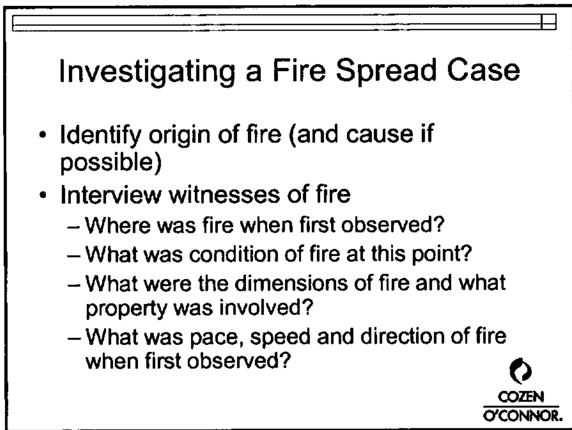
Investigating a Fire Spread Case
• Identify origin of fire (and cause if possible)
• Interview witnesses of fire
– Where was fire when first observed?
– What was condition of fire at this point?
– What were the dimensions of fire and what property was involved?
– What was pace, speed and direction of fire when first observed?
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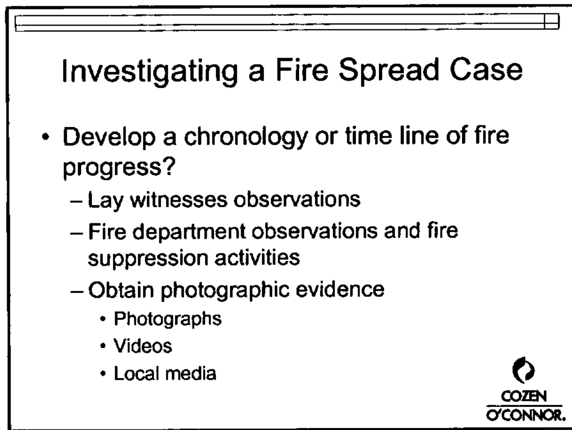
Investigating a Fire Spread Case
• Develop a chronology or time line of fire progress?
– Lay witnesses observations
– Fire department observations and fire suppression activities
– Obtain photographic evidence
• Photographs
• Videos
• Local media
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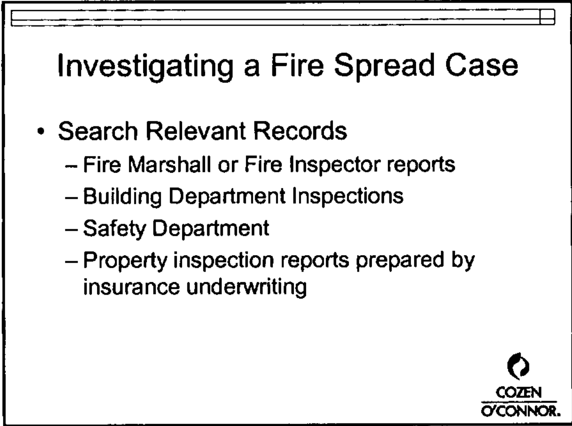
Investigating a Fire Spread Case
• Search Relevant Records
– Fire Marshall or Fire Inspector reports
– Building Department Inspections
– Safety Department
– Property inspection reports prepared by insurance underwriting
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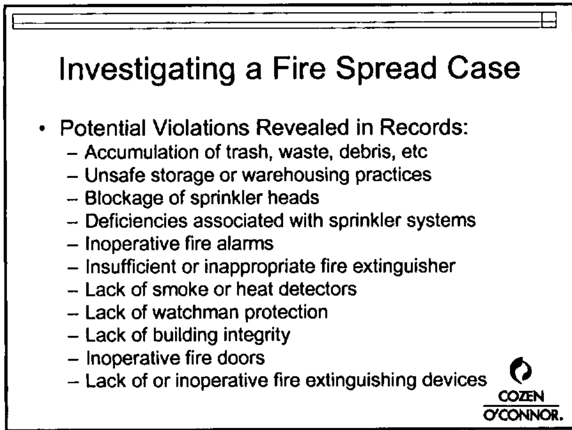
Investigating a Fire Spread Case
• Potential Violations Revealed in Records:
– Accumulation of trash, waste, debris, etc
– Unsafe storage or warehousing practices
– Blockage of sprinkler heads
– Deficiencies associated with sprinkler systems
– Inoperative fire alarms
– Insufficient or inappropriate fire extinguisher
– Lack of smoke or heat detectors
– Lack of watchman protection
– Lack of building integrity
– Inoperative fire doors
– Lack of or inoperative fire extinguishing devices
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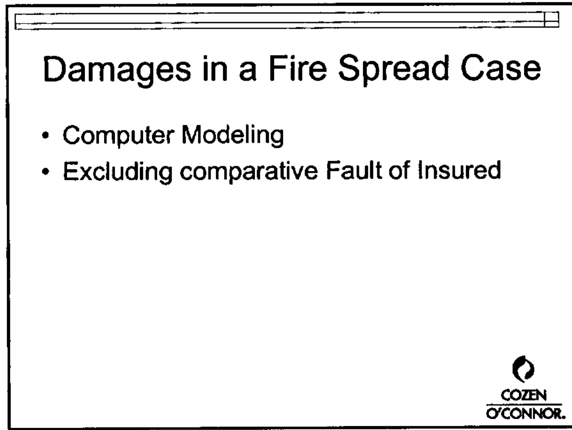
Damages in a Fire Spread Case
• Computer Modeling
• Excluding comparative Fault of Insured
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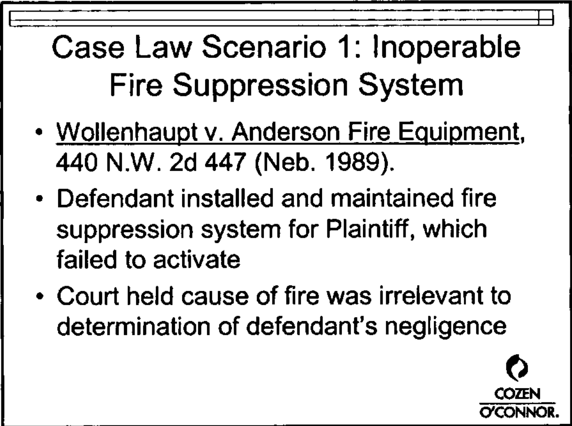
Case Law Scenario 1: Inoperable Fire Suppression System
• Wollenhaupt v. Anderson Fire Equipment, 440 N.W. 2d 447 (Neb. 1989).
• Defendant installed and maintained fire suppression system for Plaintiff, which failed to activate
• Court held cause of fire was irrelevant to determination of defendant's negligence
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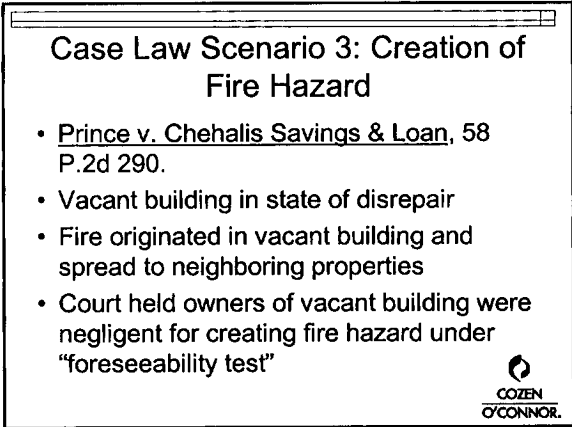
Case Law Scenario 3: Creation of Fire Hazard
• Prince v. Chehalis Savings & Loan, 58 P.2d 290.
• Vacant building in state of disrepair
• Fire originated in vacant building and spread to neighboring properties
• Court held owners of vacant building were negligent for creating fire hazard under "foreseeability test"
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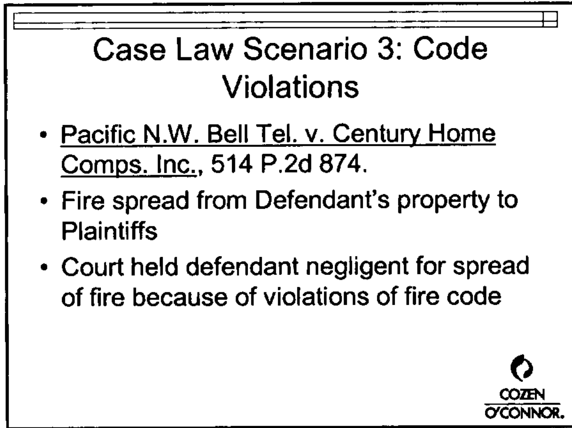
Case Law Scenario 3: Code Violations
• Pacific N.W. Bell Tel. v. Century Home Comps. Inc., 514 P.2d 874.
• Fire spread from Defendant's property to Plaintiffs
• Court held defendant negligent for spread of fire because of violations of fire code
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Case Law Scenario 4: Delay in Reporting Fire

- Fireman's Fund Ins. Co. v. AALCO Wrecking Co., 466 F.2d 179.
- Defendant performing demolition work without either securing building or employing watchmen, per local code.
- Fire spread to Plaintiff's property
- Court held there was sufficient evidence of a delay in discovering and reporting fire to submit to jury.

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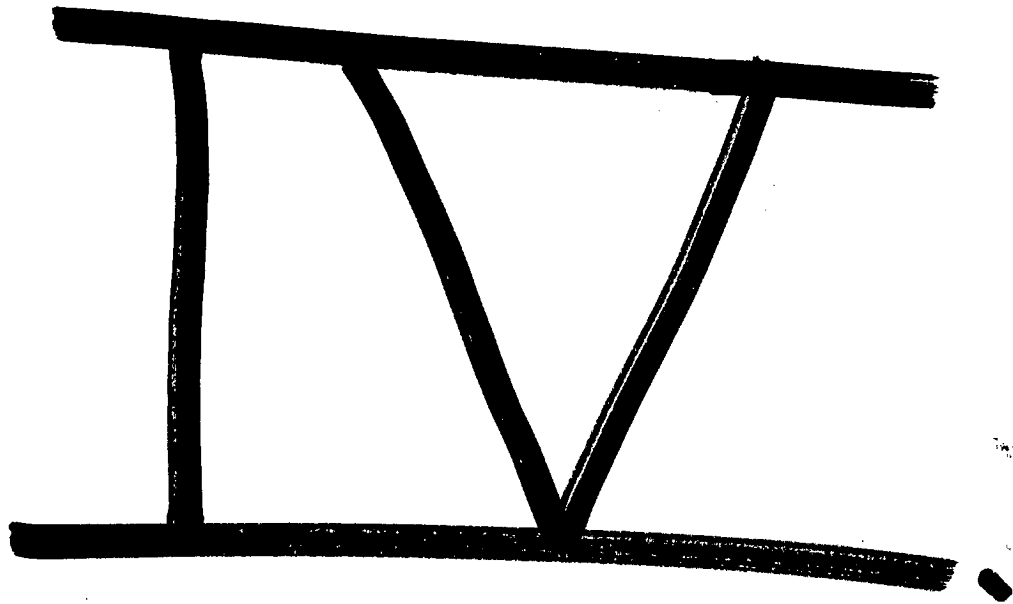

FIRE SCENE PHILOSOPHY

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FIRE SCENE PHILOSOPHY

Long after a fire scene is demolished, activities that transpired during the initial investigation of the fire affect whether and how any subrogation claim will proceed. It is critical to successful subrogation to follow a proven process that confirms the area of fire origin, identifies all potential fire causes within the area of origin, places potentially responsible parties on notice and invites them to participate at the scene, and preserves essential evidence. The process of investigation is outlined in National Fire Protection Association Pamphlet 921, the *Guide for Fire and Explosion Investigations* (NFPA 921).

Any fire investigation that does not follow NFPA 921 can be subject to criticism. As a practical matter, a failure to adhere to the guidelines of NFPA 921 will likely have a negative impact on the value of the subrogation claim. What follows is a compilation of several important provisions of NFPA 921. The seminar presentation will apply these principles of fire investigation to events that occurred in an actual subrogation lawsuit.

Basic Methodology

Nature of Fire Investigations. A fire or explosion investigation is a complex endeavor involving skill, technology, knowledge, and science. The compilation of factual data, as well as an analysis of those facts, should be accomplished objectively and truthfully. The basic methodology of the fire investigation should rely on the use of a systematic approach and attention to all relevant details. The use of a systematic approach often will uncover new factual data for analysis, which may require previous conclusions to be reevaluated. With few exceptions, the proper methodology for a fire or explosion investigation is to first determine and establish the origin(s), then investigate the cause: circumstances, conditions, or agencies that brought the ignition source, fuel, and oxidant together. NFPA 921, Par. 2.1

Conducting the Investigation. The investigator should conduct an examination of the scene, if it is available, and collect data necessary to the analysis. The actual investigation may take and include different steps and procedures, and these will be determined by the purpose of the investigation assignment. . . . A typical fire or explosion investigation may include all or some of the following: a scene inspection; scene documentation through photography and diagramming; evidence recognition, documentation, and preservation; witness interviews; review and

analysis of the investigations of others; and identification and collection of data from other appropriate sources. NFPA 921, Par. 2.4.3.

Management of Major Investigations. Understanding Between the Parties. Interested parties should be allowed to participate in the investigation and examine the evidence in its undisturbed condition. No party should remove evidence or materials without adequate notice to other interested parties. NFPA 921, Par. 24.2.

Investigation of Fire Origin

Origin Determination. The area of origin is almost always determined by examining the fire pattern evidence of the fire scene, starting with the areas of least damage and moving toward the area of greatest damage. If identifiable, movement and intensity fire patterns should be traced back to an area or point of origin. Once the area of origin has been established, the investigator should be able to understand and document the fire spread. The purpose of determining the origin of the fire is to identify the geographical location where the fire began. Once the area of origin has been determined, based on the patterns produced by the movement of heat, flame, and smoke, then the specific location of the origin can be identified. the specific origin will be where the heat ignited the first fuel and is commonly referred to as the point of origin. NFPA 921, Par. 15.1.

Fire-Spread Scenario. If an area of origin is identified, then all potential ignition sources should be located and identified for a further reduction of the area of origin to a point of origin. NFPA 921, Par. 15.8.

Investigation of Fire Cause

Cause Determination. The determination of the cause of a fire requires the identification of those circumstances and factors that were necessary for the fire to have occurred. Those circumstances and factors include, but are not limited to, the device or equipment involved in the ignition, the presence of a competent ignition source, the type and form of the material first ignited, and the circumstances or human actions that allowed the factors to come together to allow the fire to occur. NFPA 921, Par. 16.1.

Classification of Cause. The cause of a fire may be classified as accidental, natural, incendiary (arson), or undetermined.

> Accidental fires involve all those for which the proven cause does not involve a deliberate human act to ignite or spread fire into an area where fire should not be.

Natural fire causes involve fires caused without direct human intervention, such as lightning, earthquake, wind, and the like.

The incendiary fire is one deliberately ignited under circumstances in which the person knows that the fire should not be ignited.

Whenever the cause cannot be proven, the proper classification is *undetermined.*

NFPA 921, Par. 16.2, 16.2.1., 16.2.2, 16.2.3, 16.2.4.

Preservation of Fire Scene Evidence

Collecting and Preserving Evidence. Valuable physical evidence should be recognized, properly collected, and preserved for further testing and evaluation or courtroom presentation. NFPA 921, Par. 2.4.4.

The decision on what physical evidence to collect at the incident scene for submission to a laboratory or other testing facility for examination and testing, or for support of a fact or opinion, rests with the fire investigator. This decision may be based on a variety of considerations, such as the scope of the investigation, legal requirements, or prohibition. Additional evidence may also be collected by others, including other investigators, insurance company representatives, manufacturer's representatives, owners, and occupants. The investigator should also be aware of issues related to spoliation of evidence. NFPA 921, Par. 14.2.

Generally, the cause of a fire or explosion is not known until near the end of the investigation. Therefore, the evidentiary or interpretative value of various pieces of physical evidence observed at the scene may not be known until, at, or near the end of the fire scene examination, or until the end of the complete investigation. As a result, the entire fire scene should be considered physical evidence and should be protected and preserved. NFPA 921, Par. 14.3.

Role and Responsibility of Fire Investigator. If the fire fighters have not taken the preliminary steps to preserve or protect the fire scene, then the fire investigator should assume the responsibility for doing so. Then, depending on the individual's authority and responsibility, the investigator should document, analyze, and collect the evidence. NFPA 921, Par. 14.3.5.

Practical Considerations. The precautions in this section should not be interpreted as requiring the unsafe or infinite preservation of the fire scene. It may be necessary to repair or demolish the scene for safety or for other practical reasons.

Once the scene has been documented by interested parties and the relevant evidence removed, there is no reason to continue to preserve the scene. The decision as to when sufficient steps have been taken to allow the resumption of normal activities should be made by all interested parties known at that time. NFPA 921, Par. 14.3.6.

Spoliation of Evidence

Spoliation of evidence refers to the loss, destruction, or material alteration of an object or document that is evidence or potential evidence in a legal proceeding by one who has the responsibility for its preservation. Spoliation of evidence may occur when the movement, change, or destruction of evidence, or the alteration of the scene significantly impairs the opportunity of other interested parties to obtain the same evidentiary value from the evidence, as did any prior investigator. NFPA 921, Par. 9.3.6.1.

Fire investigation usually requires the movement of evidence or alteration of the scene. In and of itself, such movement of evidence or alteration of the scene should not be considered spoliation of evidence. . . . Still another consideration is protection of the evidence. There may be cases where it is necessary to remove relevant evidence from a scene in order to ensure that it is protected from further damage or theft. Steps taken to protect evidence should also not be considered spoliation. NFPA 921, Par. 9.3.6.6.

Colorado Cases on Spoliation of Evidence

Spoliation of evidence continues to be a frequently asserted defense, but can also be alleged by plaintiffs against defendants. Courts are still developing the boundaries of spoliation and establishing remedies when spoliation occurs, as shown in three recent Colorado cases:

> *Robert Phantz and Mid-Century Insurance Company v. Kmart Corporation and Waymar Industries,* 83 P.3d 564 (Colo. App. 2003)

Phantz claimed that he was injured when he sat down on a bench outside a Kmart store. Shortly after the incident, Phantz notified Kmart that the bench should be preserved as evidence. However, the bench remained in use at the Kmart store for over two years.

During that time, Phantz's expert examined the bench, videotaped it, and prepared a report finding both Kmart and the bench manufacturer responsible for Phantz's injuries. Phantz's expert's theory was that when Phantz sat down, the seat back of

the bench deflected, exposing the upturned lip of the seat bottom which impacted Phantz's tailbone and injured him. Waymar, the company that manufactured the bench, had its attorney and a company representative also examine the bench while it was in use.

Kmart eventually moved the bench to a storage trailer, then couldn't find it. After the bench was located, some Kmart employees took the bench apart and threw it in a dumpster. The new store manager learned what the employees had done and retrieved the bench from the dumpster, but it was virtually destroyed.

Waymar's expert examined the bench after it was pulled out of the dumpster, but testified that because of the condition of the bench, he could not tell what effect pre-accident repairs and modifications Kmart performed on the bench may have had on Phantz's alleged injuries.

The trial court held that the bench's "evidentiary value was substantially destroyed" by Kmart's actions. The court found that if jurors could have inspected the bench and seen how far back the seat deflected, they would have been in a better position to decide whether the bench was a hazard. The court noted that the photographs and videotape taken by Phantz's expert were not a satisfactory substitute for having the bench itself at trial.

The trial court found that Kmart's actions were either intentional or reckless and instructed the jury that "the bench is presumed to be defective and that Kmart is presumed to be the cause of the defective condition." Not surprisingly, the jury found Kmart 100% at fault. The appellate court upheld the outcome and stated that the trial court's inherent power to impose a punitive sanction is not limited to intentional spoliation of evidence.

Aloi v. Union Pacific Railroad, 129 P.3d 999 (Colo. 2006)

Aloi was a Union Pacific railroad conductor. He tripped over a loose rubber mat while going down some stairs inside a locomotive. Aloi told the engineer that he had tripped on a loose rubber mat. Later that day, he telephoned the manager of yard operations. Union Pacific inspected the locomotive and took photographs. The engineer completed an inspection form, listing the loose mat as a "tripping hazard."

The next day, Aloi filed a personal injury report with Union Pacific. Within a week of the accident, Aloi's attorneys notified Union Pacific that Aloi would file a personal injury claim.

During discovery, Union Pacific was unable to produce documents relating to inspections and maintenance of the locomotive both before and after Aloi's fall. Federal railroad standards required Union Pacific to maintain these records for ninety-two days. When someone filed a claim, Union Pacific's document retention policy required a claims agent to recover the records and prevent them from being destroyed. Union Pacific claimed that it did not collect the records for the locomotive where Aloi was injured before they were destroyed because of a change in personnel.

The trial court found that Union Pacific had deliberately destroyed relevant evidence because it was on notice before the ninety-two day period expired that Aloi intended to bring a personal injury suit and that the documents would be relevant.

Union Pacific, apparently trying to avoid the consequences of its failure to preserve the documents, admitted that it was negligent in failing to properly inspect and maintain the stairwell. Union Pacific argued that, because it had admitted negligence, the missing documents were not relevant and therefore spoliation sanctions should not be imposed.

The court granted Aloi's motion requesting an adverse inference jury instruction. Three times during trial, the judge gave the jury the adverse inference instruction: first, at the close of Aloi's case in chief; second, during cross examination of one of Union Pacific's experts; and third, before sending the jury out for deliberations.

> This is the instruction that the court gave to the jury:
>
> It is the duty of a party not to take action that will cause the destruction or loss of relevant evidence, hindering the other side from making its own examination and investigation of all potentially relevant evidence relating to whether that party's fault caused the incident in question. You are instructed you may infer, by reason of the defendant's failure to produce these documents, that the evidence contained in such documents was unfavorable to defendant.

The jury returned a $6 million verdict for Aloi. The Court of Appeals reversed and ordered a new trial, finding that the trial judge had interjected himself into the advocacy process by repeating the instruction three times and by interrupting the cross examination of Union Pacific's human factors expert.

The Colorado Supreme Court said it did not matter whether a party destroyed evidence in bad faith or destroyed the evidence willfully because, regardless of a

party's mental state, the opposing party will suffer the same prejudice because the evidence is not available. The Supreme Court also held that the trial judge did not behave inappropriately in giving the adverse inference instruction three times because the judge was trying to remedy prejudice to Aloi because the evidence was not available.

Jessica Castillo v. The Chief Alternative, LLC 140 P.3d 234 (Colo. App. 2006)

Plaintiff was in a nightclub in January 2002 and alleged that she was injured when a three foot tall mirrored column fell over and hit her. The mirrored column was attached to a truss by a rod that went through the column to a motor that turned the column. It was secured on the bottom by a locknut. After the column fell over, the nightclub manager found a split locknut on the floor.

The nightclub manager kept the evidence for 1 ½ years after the incident. In June 2003, the nightclub closed and the manager threw away the mirrored column, the locknut, and everything else. Naturally, the following month, July 2003, the plaintiff filed a Complaint.

At trial, the plaintiff filed a motion seeking sanctions against the nightclub for spoliation of evidence. The plaintiff wanted to prevent the nightclub from raising the issue that the locknut the manager found had split. The plaintiff also requested an adverse inference instruction.

Like *Aloi,* this case involved allegations of spoliation before a Complaint was filed. But unlike *Aloi,* plaintiff Castillo never notified the nightclub that she intended to file suit. In fact, the nightclub manager called to check on the plaintiff about a month after the accident. Her father told the manager that his daughter "was doing OK, that her bills were being paid, that she wasn't hurt that bad, and they weren't going to sue."

About six months before he threw away the evidence, the manager asked the nightclub's liability carrier if it needed anything else from him. He was told that nothing had been filed and that the insurer did not need any other paperwork from him. He did not ask if he still needed to keep the mirrored column or other evidence.

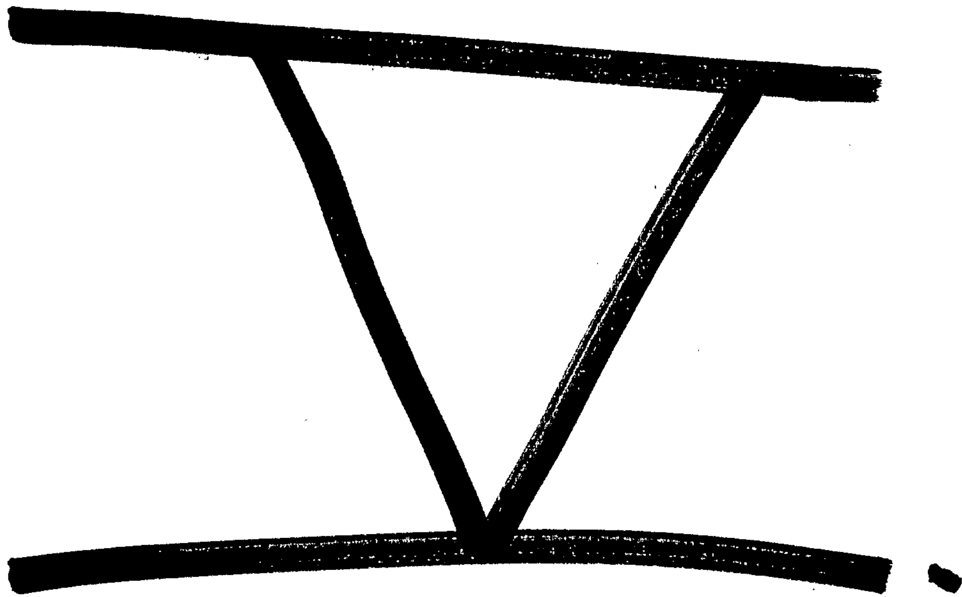
The Court of Appeals upheld the trial court's decision denying plaintiff's motion for sanctions. Significant to the ruling was the absence of any indication in the record that plaintiff ever notified the nightclub that she was planning to file a Complaint. Plaintiff also never notified the nightclub that it should preserve the

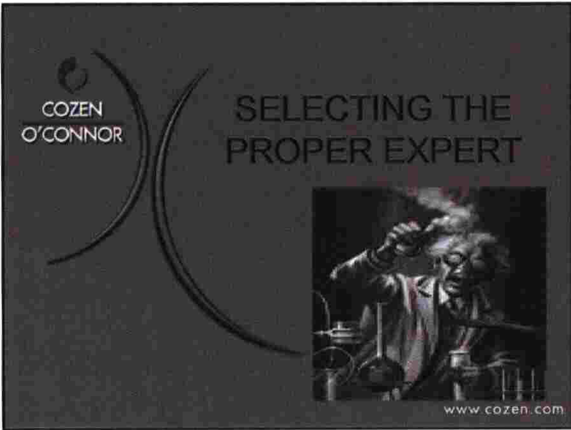
mirrored column or that she wanted to view the evidence. Plaintiff never inquired about the discarded evidence until after the Complaint was filed.

The court also found that the nightclub manager was not intentionally trying to harm the plaintiff's case. He had a legitimate reason for throwing the evidence away—the nightclub was closing. The case against the nightclub was dismissed on a directed verdict when the plaintiff could not prove that the nightclub knew or should have known that there was a problem with the locknut.

Conclusion

Following established principles in fire scene investigations, particularly the concepts stated in NFPA 921, will lead to credible investigations with supportable conclusions. Failure to follow proper procedures will have a negative influence on the outcome of the potential subrogation claim.

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SELECTING THE PROPER EXPERT
• WHAT KIND OF EXPERT DO YOU NEED
• HOW TO CHOOSE AN EXPERT
• WHAT TO EXPECT FROM YOUR EXPERT
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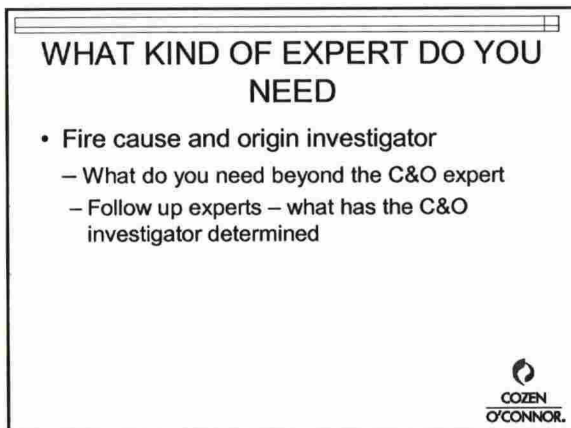
WHAT KIND OF EXPERT DO YOU NEED
• Fire cause and origin investigator
– What do you need beyond the C&O expert
– Follow up experts – what has the C&O investigator determined
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WHAT KIND OF EXPERT
DO YOU NEED
• Electrical Expert
– Building Wiring
– Appliance/product failures
– Electrical Code and UL compliance
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WHAT KIND OF EXPERT
DO YOU NEED
• Mechanical Experts
– HVAC Equipment Failures
– Mechanical Equipment/heavy equipment/automotive failures
– Manufacturing Equipment
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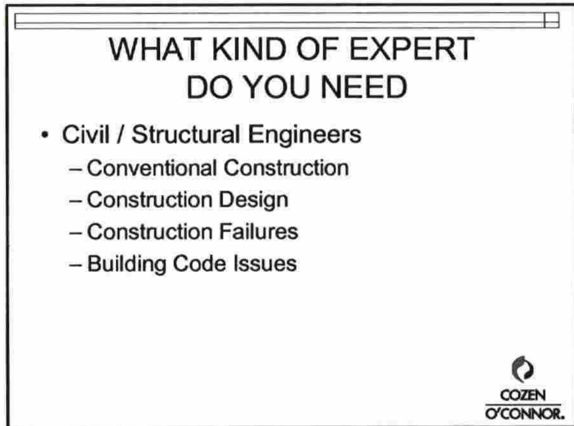
WHAT KIND OF EXPERT
DO YOU NEED
• Civil / Structural Engineers
– Conventional Construction
– Construction Design
– Construction Failures
– Building Code Issues
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WHAT KIND OF EXPERT DO YOU NEED

- Standard of Care Expert
  - The plumber, electrician, general contractor, etc.
  - Installation/maintenance, industry standards, code compliance
  - Can help connect the dots to your forensic expert

HOW TO CHOOSE AN EXPERT

- Qualifications
  - Background, training, education, experience, skill
  - Does he/she specialize in the area you need
  - Is your expert a "jack of all trades" a.k.a. "master of none"

HOW TO CHOOSE AN EXPERT

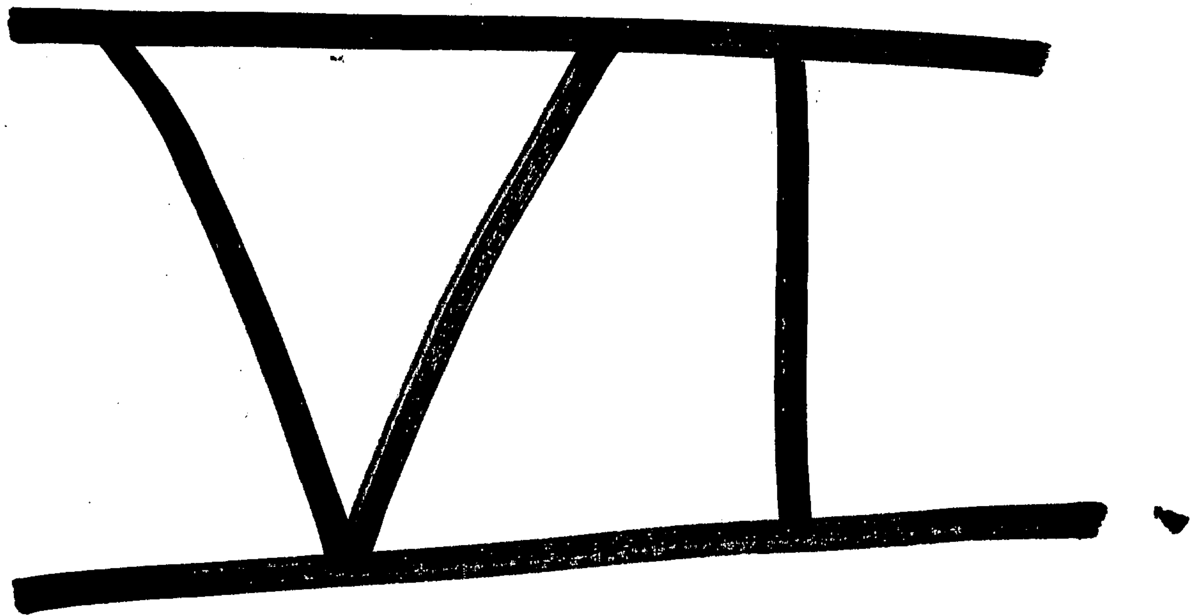
- What Kind of Witness Does/Will He/She Make
  - Can he/she defend his opinion
  - Can he communicate and articulate his opinion
  - How does he/she present

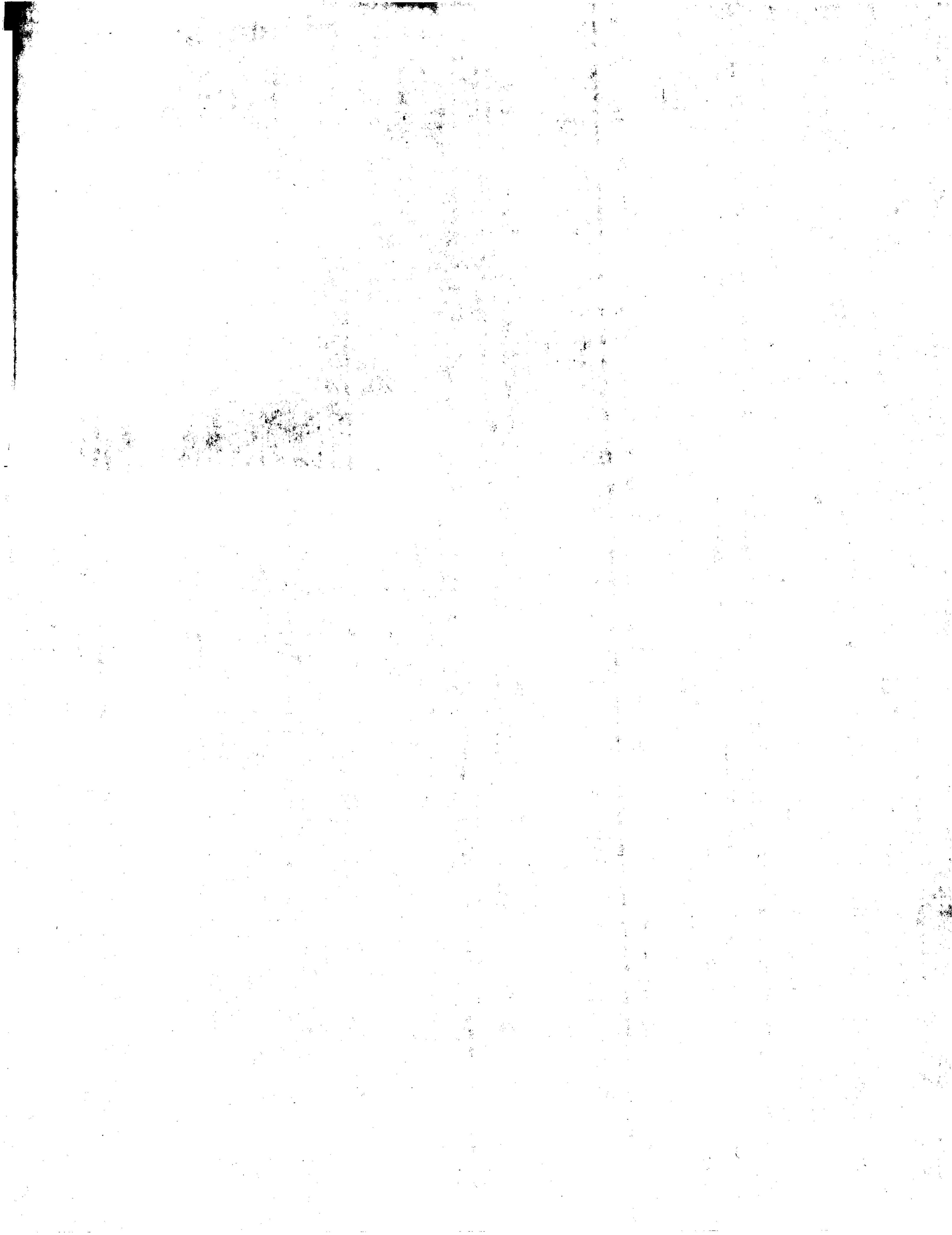
WHAT TO EXPECT FROM YOUR EXPERT

- A Thorough Investigation
  - What is the scope of his retention
  - Responsiveness/communication
  - Photographically document his investigation – the entire scene, all equipment/products, other potential causes; video
  - Follow up – what has he/she done beyond an initial scene/product investigation, i.e., interviewed witnesses, testing, product information, exemplars, research

WHAT TO EXPECT FROM YOUR EXPERT

- Communication - accessibility; available for consultation; be able to address questions/concerns with him/her
- Will Defend His Position/Opinions – does not waffle
- Honest - tells you the good, the bad and the ugly; does not tell you what he thinks you want to hear
- Litigation Savvy – has an understanding of discovery as it concerns his reports; knows how to testify and communicate
- Prepared – knows his work and weak spots, knows his file, his opinions, anticipates questions





a.

Measure of Damages in Property Loss Cases

By John W. Reis

Proving damages in a large property loss case is often tedious, sometimes complex, and occasionally treacherous. The drudgery of itemizing the damages is difficult enough. The battle over *entitlement* to economic damages is no less daunting. Once entitlement is established, the weary litigant may have little time or energy left to fully analyze the proper legal standards for recovering those damages. This article is intended as a survival manual of sorts -- a guide through the law on the proper measure of property damages in Florida.[1]

The General Rule of Recovery

For both real and personal property losses, the general rule of recovery is that a property owner can recover the cost of replacement, repair, or restoration of property, unless the damage is permanent and the restoration cost will exceed the diminution in the fair market value of the property, in which case the damages are limited to the diminution in fair market value.[2] More succinctly stated, an award of damages to property is generally limited to the restoration cost or the diminution in fair market value, whichever is less.[3] Thus, for example, in United States Steel Corporation v. Benefield, 352 So.2d 892, 894-95 (Fla. 2d DCA 1977), *cert. denied*, 364 So.2d 881 (Fla.1978), the court held that the plaintiff, a property owner, could not recover the full cost of restoring 26 damaged acres of land but was instead limited to the diminution in value, where the restoration cost was $13,084 but the property's entire value was only $12,116 ($466 per acre).

Establishing "Fair Market Value"

The term "fair market value" is defined as "the amount of money which a purchaser willing but not obliged to buy the property would pay to an owner willing but not obliged to sell

it, taking into consideration all uses to which the property is adapted and might in reason be applied."[4] Three well-recognized guides to appraisal have evolved, all of which take the property's pre-loss physical depreciation into account: "(1) the cost approach; (2) the comparable sales approach; and (3) the income or economic approach."[5]

In the appraisal and insurance industries, the term "actual cash value" is often used to describe the pre-loss value of certain property, such as vehicles or appliances or structures. Appraisal guides, such as the Kelley Blue Book[6] for vehicles or the Marshall & Swift guide[7] on structures, can help estimate the actual cash value. Although no published Florida case has directly addressed the use of these insurance appraisal guides to determine diminution in market value, language from one Florida case indicates that the term "actual cash value" is "generally synonymous" with fair market value.

In American Reliance Insurance Company v. Perez, 689 So.2d 290 (Fla. 3d DCA 1997), home owners brought a class action against their property insurer on the meaning of the term "actual cash value." In determining that the term was not ambiguous, the court essentially equated "actual cash value" with "fair market value," stating as follows:

> The insurer contends that the policy language is unambiguous – that when an insured elects not to repair or replace damage to the insured building, then the insured is entitled to be paid only the "actual cash value," *i.e.*, an amount less a deduction for prior depreciation, because the damaged portion, not being new, had suffered actual physical depreciation before the hurricane damage. ... We find that the controlling language is not ambiguous. The expression "actual cash value" is an often-used appraisal term, generally synonymous with "market value" or "fair market value."[8]

"Stigma" Damages

Damaged property sometimes carries a "stigma" associated with the event that caused the damage even after repairs have been made, especially in cases involving numerous construction defects, mold damage, or termite infestation. The owner of such

property will often desire not only the repair costs, but also the additional diminution in value associated with the stigma.

In Orkin Exterminating Company, Inc. v. DelGuidice, 790 So. 2d 1058 (5th DCA 2001), for example, the homeowners sought, and the jury awarded, $300,000 against a pest control company for the lost market value associated with the stigma of repeated termite infestations. The Fifth District reversed the award based on a provision in the parties' contract which limited the homeowners' remedy to re-treatment and repair of the damage, but went on to note that stigma/diminution damages would otherwise have been recoverable under the following circumstances:

> [T]he diminution in value damages of $300,000 could have properly been presented to the jury if competent substantial evidence had been presented that the cost to repair existing termite damage and the cost of providing effective termite eradication procedures would have constituted economic waste. In other words, had evidence been presented that the cost of repair was substantially greater than the diminution in value, diminution in value would have been the proper standard to apply.[9]

Under this holding, stigma damages are recoverable in Florida as an *element* of the diminution in market value when reparation is either impracticable or exceeds the overall diminution in value; however, such damages are not recoverable in *addition* to the repair cost when the diminution in value exceeds the repair cost.[10]

Proof Through a "Qualified" Witness

Courts require that proof of lost fair market value be established by competent, substantial evidence through a "qualified" witness.[11] Generally, the use of expert testimony is preferred.[12] However, most courts will allow a non-expert owner to testify to the value of his or her own property.[13] The rule is "based on the owner's presumed familiarity with the

characteristics of the property, his knowledge or acquaintance with its uses and purposes, and his experience in dealing with it."[14]

Burden to Establish the Lesser Figure

Because the owner is generally limited to the lesser of the restoration cost or the diminution in value, one issue which occasionally arises at trial is whether the owner has the burden to introduce both figures in order to establish which one is the lowest. One Florida case holds that an owner seeking repair costs need not prove that repair costs exceeded diminution in market value,[15] but another case holds that an owner seeking the diminution in value must show that repairs were either impracticable or in excess of the diminution in value.[16] Close analysis of the two cases highlights the distinction.

In American Equity Insurance Co. v. Van Ginhoven, 788 So. 2d 388 (Fla. 5th DCA 2001), plaintiff introduced evidence of, and was awarded at trial, a restoration cost of $48,144.50 for damages to a swimming pool caused by a contractor. On appeal, defendant argued that the damages should have been limited to the difference between the value of the land before and after the damages occurred. In its opinion, the court allowed the award to stand, noting that *neither* party introduced evidence to establish that the $48,144.50 was higher than the diminution in value:

> In the instant case, Fernandez proved that the costs associated with replacing the pool and repairing the damages less significant upgrades, was $48,144.50. The record fails to demonstrate that this cost exceeded the value of the pool in its original condition or its depreciation in value. Moreover, Fernandez demonstrated that replacing and repairing the damage was practicable by actually having it done. Accordingly, American Equity has failed to demonstrate on appeal that the trial judge erred in awarding Fernandez the cost associated with replacing her pool and repairing the other damaged property.[17]

Conversely, in Orkin Exterminating Company, Inc. v. DelGuidice, 790 So. 2d 1058 (5th DCA 2001), the plaintiff introduced evidence of diminution in value caused to a

house infested with termites but failed to establish that restoration would be either impracticable or in excess of the diminution in value. The court reversed the award and limited the remedy to the contract's exclusive remedy of repair, but also stated that it would have affirmed the diminution award if the plaintiff had shown the remedy of repair to be impracticable or "wasteful," *i.e.*, in excess of the diminution value. The distinction between the two cases is that the plaintiff in Van Ginhoven established the practicability of restoration by actually performing it, whereas the plaintiff in DelGuidice apparently abandoned the repair efforts and introduced no evidence that restoration was practicable.

The cautious practicioner should thus establish the practicability of restoration when seeking restoration costs or the impracticability/wastefulness of restoration when seeking diminution in value, leaving it to the opposing party to show that the alternative remedy is practicable, quantifiable, and lower.[18]

Going Beyond the Lesser Figure

Limitation to the lesser of the restoration cost or the diminution in value of an item of property does not necessarily prevent a party from introducing the higher figure into evidence. For example, the replacement cost of damaged property can be introduced as relevant evidence on the question of the diminution in value, or vice versa, in order to assist the jury in determining the degree of injury to the property.[19] In addition, courts have allowed recovery for loss of use, code upgrades, debris removal, waste remediation, personal or sentimental value, and extra value for unique service structures.

Loss of Use: Personal Property

In the personal property context, an owner is entitled to recover not only for repairs but also for the loss of use of property, so long as the loss is not total and the owner actually opts to repair.[20] The rule derives from the Restatement of Torts § 928 (1939), which provides:

> Where a person is entitled to a judgment for harm to chattels not amounting to a total destruction in value, the damages include compensation for
> (a) the difference between the value of the chattel before the harm and the value after the harm, or at the plaintiff's election, the reasonable cost of repairs or restoration where feasible, with due allowance for any difference between the original value and the value after repairs, and
> (b) the loss of use.

This provision was construed in Badillo v. Hill, 570 So.2d 1067, 1068 (Fla. 5th DCA 1990) as entitling the plaintiff in that case to make an election as to the theory of recovery, but preventing plaintiff from obtaining "a combination of cost of repairs plus lessened value before repairs, because that would permit a double recovery."[21]

Loss of Use/Living Expenses: Real Property

In the real property context, most jurisdictions follow the same rule as with personal property, allowing loss of use of realty if the damage caused the owner to be unable to use the property for a period of time.[22]

Code Upgrades

Property owners, faced with repairing or replacing property, may be required to comply with a regulation or code either newly enacted or from which the owner was previously exempt before the loss. Although no published Florida decision appears to have squarely addressed the issue in the tort or breach of contract context,[23] other jurisdictions have allowed the additional cost of code compliance.[24] Rationales for allowing such recovery include incentive to avoid cutting corners in the reconstruction and weighing the interests of public safety and the owner's full use of the property against the tortfeasor who caused the damage.

Debris Removal

Structural damages often involve removal of debris before rebuilding can begin. If the costs of debris removal is included within the overall rebuilding cost and if that total cost is less than the diminution in value, it follows that the cost is recoverable. However, in cases where the debris removal cost causes the restoration cost to exceed the diminution in market value or when a destroyed structure is not rebuilt but debris removal costs are nonetheless incurred, the question becomes whether the cost to remove debris from the land is recoverable *in addition* to the diminution in market value of the structure. Although no Florida cases provide a direct answer, this author argues that the cost of removing structural debris from the land should be allowed in either situation. The structure and land are separate items of property. Debris damages the land, not the structure. Debris removal restores the land, not the structure, especially where the structure is not rebuilt. Rebuilding of the structure does not commence until the old structural debris is removed. In addition, the land's diminution in value will be directly affected by the need to remove the debris. Accordingly, the debris removal cost should be recoverable as an element of the land damage separate and apart from the damage to the structure.

In rare instances, the debris will not have been removed by the time of trial. Nonetheless, the presence of debris will likely affect the value of the property to a potential purchaser, as with stigma damages discussed above in DelGuidice. Applying the DelGuidice rationale, the presence of debris should be a factor in determining the diminution of value even when the debris has not actually been removed.

Waste Remediation

In cases of damage to land caused by pollution or waste, public policy would seem to weigh in favor of allowing the owner the full cost to remediate the land in excess of diminution

in value as an incentive to remove the hazards posed by such waste. Early cases on the issue, however, were reluctant to allow such full remediation if the cost exceeded diminution in value. For example, in both Standard Oil Co. v. Dunagan, 171 So.2d 622 (Fla. 3d DCA 1965) and Crown Cork & Seal Co. v. Vroom, 480 So.2d 108 (Fla. 2d DCA 1985), landowners who sought restoration costs for contamination of their groundwater were limited to the diminution in value.

More recently, the Florida Supreme Court distinguished those cases in Davey Compressor Company v. City of Delray Beach, 639 So.2d 595 (Fla. 1994). There, the court awarded the City of Delray Beach the full cost of restoration of land polluted by the defendant. While not expressly receding from Dunagan and Vroom, the decision in Davey Compressor Company gave increased emphasis on the public policy of full remediation where the contamination adversely affects the public:

> Recognizing the environmental dangers that are directly associated with the negligent contamination of groundwater, we find that public policy supports restoration costs as the measure of damages in this case.[25]

Thus, entitlement to full remediation costs above diminution in value may be recoverable if the land poses a public health hazard.

Personal, Peculiar, or Sentimental Value

Certain property will possess a special value to the owner that is difficult to quantify in terms of market value. For example, family heirlooms, photographs, or other irreplaceable items are often imbued with tremendous sentimental value, but little objective market value. When such items are destroyed, the owner naturally desires compensation above the fair market value. Most jurisdictions will allow recovery above the objective diminution in market value for such items in certain circumstances.[26] Florida follows that trend.

In Carye v. Boca Raton Hotel and Club Limited Partnership, 676 So. 2d 1020 (Fla. 4th DCA 1996), the plaintiff, who lost jewelry acquired over a lifetime, sought entitlement to the sentimental value of the lost items. The Fourth District began by recognizing the right to recover for lost sentimental value in special circumstances, such as where the item has no market value or where limitation to the fair market value would be "manifestly unfair":

> It is often impossible to place what is a current market value on such articles but the law does not contemplate that this be done with mathematical exactness. The law guarantees every person a remedy when he has been wronged. If the damage is to personal property as in this case, it may be impossible to show that all of it had a market value. In fact it may be very valuable so far as the owner is concerned but have no value so far as the public is concerned. It would be manifestly unfair to apply the test of market value in such cases.[27]

The court then noted that the jewelry in question "obviously possessed sentimental value, as it was accumulated over forty-eight years of marriage and included engagement rings, wedding bands and anniversary presents."[28] However, because the jewelry "also had significant market value" -- $156,470 to be precise – and because limitation to that value was not "manifestly unfair," the court held that it was improper for the court to have allowed testimony regarding its sentimental value:

> [W]e conclude that in a situation where the lost property has both a market value and sentimental value, as is the case here, the burden again rests with the plaintiff to prove that the market valuation would be manifestly unfair.[29]

Under the Carye approach, a jury may consider the sentimental value of a lost item so long as plaintiff proves that (1) the item had sentimental value and (2) either (a) the item had no quantifiable market value or (b) limitation to the market value "would be manifestly unfair."

Unique Structures

Related to the issue of sentimental value is the issue of entitlement to damages beyond market value for unique service-type structures belonging to religious groups, hospitals, country

clubs, schools, colleges, charitable societies, and similar organizations. Although this author has uncovered no Florida cases directly addressing the issue, courts from other jurisdictions have recognized that diminution in fair market value may not adequately quantify the actual loss for such unique structures.[30] The principles announced in Carye, allowing damages beyond market value upon proof that such limitation would be "manifestly unfair," can be applied by analogy to such structures.

Goods for Sale

In the business context, the general rule is that the proper measure of damages for goods held for sale is not the retail selling price but is limited to wholesale cost of the goods at the time of the loss.[31]

> [T]he owner of a stock of goods held for sale, which has been damaged or destroyed, is entitled to recover, as damages, the reasonable cost of replacing such goods, which includes the wholesale cost at the time of the loss, plus any other reasonable expenses incurred in the replacement.[32]

The proper market for determining the market value of such goods is the wholesale market to which the injured party would have to go to in order to replace the goods.[33]

Conclusion

The road to recovery in substantial property loss cases can be twisted, dark, and scary. The practicioner cannot simply rely on the general rule limiting recovery to the lesser of either the restoration cost or the diminution in value, without also understanding the nuances of the issues covered in this article. The applicable law on these issues should be read thoroughly and, in many cases, will need to be applied by analogy in the absence of cases directly on point. As with any rough terrain, it should be traveled carefully, cautiously, and with as many guides as possible.

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[1] This article also draws from analogous case law in other Southeastern states, including Georgia, South Carolina, North Carolina, Virginia, Kentucky, Tennessee, Alabama, and Mississippi.
[2] United States Steel Corporation v. Benefield, 352 So.2d 892 (Fla. 2d DCA 1977), *cert. denied*, 364 So.2d 881 (Fla.1978); American Equity Insurance Co. v. Van Ginhoven, 788 So. 2d 388, 391 (Fla. 5th DCA 2001); Bisque Associates of Florida, Inc. v. Power of Quayside No. II Condominium Association, 639 So. 2d 997 (Fla. 3d DCA 1994); Keyes Co. v. Shea, 372 So.2d 493 (Fla. 4th DCA 1979); Airtech Service, Inc. v. MacDonald Construction Company, 150 So.2d 465 (Fla. 3d DCA 1963). *Cf.* Fuller v. Martin, 125 So.2d 4 (Ala. 1960);; Ryland Group v. Daley, 537 S.E.2d 732, 738 (Ga. Ct. App. 2000); Ray v. Strawsma, 359 S.E.2d 376 (Ga. Ct. App. 1987); Island Creek Coal Company v. Rodgers, 644 S.W.2d 339 (Ky. 1982); System Fuels, Inc. v. Barnes, 363 So.2d 747 (Miss. 1978)(Measure of damages for permanent injury to land is diminution in value; but where the property can be restored to its former condition at a cost less than the value determined by the diminution of the value of the land, the measure of damages is the cost of restoration of the property plus compensation for the loss of its use.); Huberth v. Holly, 462 S.E.2d 239 (NC Ct. App. 1995) ("[T]he general rule is that where the injury is completed (as opposed to a continuing wrong) the measure of damages 'is the difference between the market value of the property before and after the injury.' Huff v. Thornton, 23 N.C.App. 388, 393-94, 209 S.E.2d 401, 405 (1974)"); Scott v. Fort Roofing and Sheet Metal Works, Inc., 299 S.C. 449, 385 S.E.2d 826 (1989) ("Cost of repair or restoration is a valid measure of damages for injury to a building although compensation may be limited to the value of the building before the damage was inflicted."); Redbud Coop. Corp. v. Clayton, 700 S.W.2d 551, 560-61 (Tenn. Ct. App. 1985) ("Our appellate courts have uniformly held that the measure of damages for injury to real estate is the difference between the reasonable market value of the premises immediately prior to and immediately after injury but if the reasonable cost of repairing the injury is less than the depreciation in value, the cost of repair is the lawful measure of damages."); Chambers v. Spruce Lighting Co., 95 S.E. 192 (W.V. 1918).
[3] Courtney Enterprises, Inc. v. Publix Supermarkets, Inc., 788 So. 2d 1045 (Fla. 2d DCA 2001).
[4] American Reliance Insurance Company v. Perez, 689 So.2d 290 (Fla. 3d DCA 1997) (quoting City of Tampa v. Colgan, 121 Fla. 218, 230, 163 So. 577, 582 (1935) and citing 4 Nichols on Eminent Domain § 12.02[1], at 12-62 to 12-70 (rev. 3d ed. 1996)). *See also* Ocean Electric Company v. Hughes Laboratories, Inc., 636 So. 2d 112 (Fla. 3d DCA 1994) (fair market value looks at "the price which would be agreed upon at a voluntary sale between a willing seller and a willing purchaser."); Charles T. McCormick, *Damages* § 44 (1935) (market value defined as sale by leisurely seller to willing buyer).
[5] American Reliance Insurance Company v. Perez, 689 So.2d 290 (Fla. 3d DCA 1997) (citing McNayr v. Claughton, 198 So. 2d 366, 368 (Fla. 3d DCA 1967).

[6] *See, e.g.*, Kelley, Blue Book Used Car Guide: Private Party, Trade-in, Retail Values, 1987-2001 Used Car and Truck, July-Dec. 2002 (May 2002).
[7] *See, e.g.*, Marshall & Swift, Residential Cost Handbook (2002).
[8] 689 So. 2d at 291.
[9] 790 So. 2d at 1160.
[10] Similarly, in Ryland Group v. Daley, 537 S.E.2d 732, 739 (Ga. Ct. App. 2000), the jury awarded homeowners the cost to repair a house plus "stigma" damages associated with the home's history of construction defects. The trial court, however, subtracted the stigma damages, limiting the award to the reparation costs. On appeal, the appellate court affirmed the reduction, noting that stigma damages are not to be added to the cost to repair, though such damages may be recoverable as an element of the diminution in value. Because the plaintiff in Ryland Group had failed to introduce evidence of the home's fair market value -- a fundamental predicate to establishing diminution in value – there was no competent evidence to support the award.
[11] *E.g.*, Hillside Van Lines, Inc. v. Matalon, 297 So. 2d 848 (Fla. 3d DCA 1974); McDonald Air Conditioning, Inc. v. John Brown, Inc., 285 So. 2d 697 (Fla. 4th DCA 1973).
[12] Kipps v. Virginia Natural Gas, Inc., 441 S.E.2d 4, 5 (Va. 1994) ("An opinion on value is inadmissible when there is not evidence to support the opinion.").
[13] First Interstate Development Corp. v. Ablanedo, 476 So. 2d 692 (Fla. 5th DCA 1985) ("The rule has been established in Florida that an owner may testify as to the value of property which he owns."); Hill v. Marion County, 238 So.2d 163 (Fla. 1st DCA 1970); Harbond, Inc. v. Anderson, 134 So.2d 816 (Fla.2d DCA 1961); Salvage & Surplus, Inc. v. Weintraub, 131 So.2d 515 (Fla. 1st DCA 1961)"). *Cf* Imac Energy, Inc. v. Tittle, 590 So. 2d 163, 168 (Ala. 1991); Jetton v. Jetton, 502 So. 2d 756, 760 (Ala. 1987); Bono v. Hamilton, 669 So. 2d 912, 913 (Ala. Ct. App. 1995); Columbia Gas of Kentucky, Inc. v. Maynard, 532 S.W.2d 3 (Ky. Ct. App. 1975) (owner's estimate of what lost items were worth to him, unless so obviously preposterous as to be devoid of probative value, is enough to support award by properly instructed jury; that award must represent what property was actually worth to him in money, excluding any sentimental or fanciful value that for any reason he might place upon it, is a qualification to be incorporated in instructions.); Goodson v. Goodson, 551 S.E.2d 200 (NC Ct. App. 2001); Appeal of Boos, 382 S.E.2d 769 (NC Ct. App. 1989); Bumgarner v. Tomlin, 375 S.E.2d 520 (NC Ct. App. 1989); Responsible Citizens v. City of Asheville, 302 S.E.2d 204 (NC 1982); Doty v. Parkway Homes Co., 295 S.C. 368, 368 S.E.2d 670 (S.C. 1988)(An owner is competent to testify on his own behalf as to the reasonable value of his household goods.)). *See generally* 31 Am.Jur.2d Expert & Opinion Evidence, § 142. *But see* Port Largo Club, Inc. v. Warren, 476 So. 2d 1330 (Fla. 3d DCA 1985) ("Where fair market value is at issue, expert testimony is necessary to prove the value thereof."); Town of Rocky Mount v. Hudson, 421 S.E.2d 407, 409 (Va. 1992)(landowner's testimony that taking "ha[d] hurt [him] $20,000, at least" was insufficient to support damage award.").
[14] First Interstate Development Corp. v. Ablanedo, 476 So. 2d 692 (Fla. 5th DCA 1985).
[15] American Equity Insurance Co. v. Van Ginhoven, 788 So. 2d 388 (Fla. 5th DCA 2001).
[16] Orkin Exterminating Company, Inc. v. DelGuidice, 790 So. 2d 1058 (5th DCA 2001).
[17] Id. at 391.
[18] *Cf.* Magnus Homes, LLC v. Derosa, 545 S.E.2d 166, 167 (Ga. Ct. App. 2001) (affirming a judgment for repair costs even though the owner "failed to adduce any evidence of the diminution in the value of the residence constructed."); Bell v. First Columbus National Bank,

493 So.2d 964, 965 (Miss. 1986) ("Plaintiff can choose to prove either the reasonable cost of replacement or repairs or diminution in value, and if he proves either of these measures with reasonable certainty, damages are allowable, so long as the plaintiff will not be unjustly enriched and the defendant does not demonstrate that there is a more appropriate measure of damages."); Nutzell v. Godwin, 1989 WL 76306 at *1-2 (Tenn. Ct. App.) ("We hold that the plaintiffs do not have the burden of offering alternative measures of damages. The burden is on the defendant to show that the cost of repairs is unreasonable when compared to the diminution in value due to the defects and omissions.").

[19] Fuller v. Martin, 125 So.2d 6 (Ala. 1961); Ryland Group v. Daley, 537 S.E.2d 732 (Ga. Ct. App. 2000) ("This difference in value may be illustrated by the reasonable cost of repair of defects.") (quoting Eldridge, Georgia Personal Injury & Property Damage – Damages, §§ 8-2 and 8-3); Huberth v. Holly, 462 S.E.2d 239 (NC Ct. App. 1995) ("Nonetheless, replacement and repair costs are relevant on the question of diminution in value and when there is evidence of both diminution in value and replacement cost, the trial court must instruct the jury to consider the replacement cost in assessing the diminution in value."); Richard W. Cooper Agency v. Irwin Yacht & Marine Corp., 264 S.E.2d 768 (NC Ct. App. 1980) ("[T]he law recognizes that the cost of repairs has a logical tendency to shed light upon the question of the difference in market value."); Redbud Coop. Corp. v. Clayton, 700 S.W.2d 551, 561 (Tenn. Ct. App. 1985) ("Of course, the trier of fact can also take into consideration the reasonable cost of restoring the property to its former condition in arriving at the difference in value immediately before and after the injury to the premises."); Averett v. Shircliff, 237 S.E.2d 92 (Va. 1977) ("The reasonable cost of repairs is one of the evidentiary factors in determining the market value of an automobile after it has been damaged.").

[20] Florida Drum Company v. Thompson, 668 So.2d 192 (Fla. 1996) ("Any loss of use, deterioration, or other damage that occurs after this reasonable period of time has passed is not the defendant's responsibility."); Badillo v. Hill, 570 So.2d 1067, 1068-69 (Fla. 5th DCA 1990); Hillside Van Lines, Inc. v. Matalon, 297 So.2d 848 (Fla. 3d DCA 1974) ("A person whose chattel is damaged, but not totally destroyed, is entitled to the difference between the value before and after the damage, or at his election, the reasonable cost of repair with due allowance for the difference between the original value and the value after repair and to be compensated for the loss of use); *Cf.* Newman v. Brown, 90 S.E.2d 649 (SC 1955).

[21] citing Merrill Stevens Dry Dock Co. v. Nicholas, 470 So.2d 32 (Fla. 3d DCA 1985). The court in Badillo went on to hold that loss of use is limited to a "reasonable time" – a period measured on an objective basis and not accounting for plaintiff's actual financial or physical ability to expeditiously repair the item – and allowed reasonable rental costs to be used a measure of loss of use damages, whether or not the plaintiff actually rented another item. *Cf.* Averett v. Shircliff, 237 S.E.2d 92 (Va. 1977) (deviating slightly from § 928 of the Restatement of Torts by deeming the measure of damages for an item that can be restored to its former condition to be the reasonable cost of repairs "with reasonable allowance for depreciation.").

[22] System Fuels, Inc. v. Barnes, 363 So.2d 747 (Miss. 1978)(allowing loss of use expense in addition to the cost restoration of the property); Huff v. Thornton, 213 S.E.2d 198, 204 (NC 1975) ("To stop [at diminution in value] would not fully compensate the plaintiffs for the losses sustained by them as a direct and natural result of the negligence of the defendants. ... [T]he plaintiffs cannot have the use of their house during the time reasonably necessary for its repair or replacement and must obtain lodging elsewhere for such period of time. For this loss they are

entitled to recover ...."). *Compare* Standard Oil Co. v. Dunagan, 171 So.2d 622 (Fla. 3d DCA 1965) (plaintiffs whose land was permanently damaged from discharge of gasoline from defective tanks and who sought diminution in value damages plus loss of use of water supply rather than cost of repairs were not entitled to *add* the loss of use figure to their recovery, but were allowed to *factor* the loss of use into the diminution in value) *with* Blake v. Hi-Lu Corp., 781 So.2d 1122 (Fla. 3d DCA 2001) (reinstating jury verdict that had awarded damages not only for repair costs of a home damaged by Hurricane Andrew, but also for "loss of use.") and American Equity Insurance Co. v. Van Ginhoven, 788 So. 2d 388, 391 (Fla. 5th DCA 2001) (in affirming plaintiff's award for the cost to repair a home, court stated, "Clearly, loss of use damages can be considered as part of the overall damages," citing to Standard Oil Co. v. Dunagan, 171 So.2d 622 (Fla. 3d DCA 1965); but court actually affirmed the trial court's *denial* of loss use, on the ground that the trial court's award of prejudgment interest was an adequate substitute for loss of use.).

[23] In the eminent domain context, owners have been denied compensation for compliance with code upgrades. State Department of Transportation v. Bennett, 592 So.2d 1150 (Fla. 4th DCA 1992); Malone v. Div. of Admin., Dep't of Transp., 438 So.2d 857 (Fla. 3d DCA 1983), *rev. denied*, 450 So.2d 487 (Fla.1984). However, the owners in Malone had rebuilt their processing plant on an entirely different parcel of land and the owners in Bennett had sought the diminution in value rather than the cost to repair. Arguably, the public policy implications of condemnation proceedings distinguish such cases from tort and breach of contract actions. Eminent domain proceedings provide "just compensation" to the owner for the taking of property. The purpose of the taking is to benefit and protect the public. There is no similar balancing test between "just" compensation and public benefit in tort and breach of contract cases, where the loss originated not for public benefit but by a third party's breach of duty.

[24] Service Unlimited v Elder, 542 N.W.2d 855 (Iowa Ct. App. 1995) (Court properly computed damages for inadequate insulation by using "cost of repair" instead of "reduction in value" where there was insufficient space between ceiling and roof to simply add additional layer of insulation over existing insulation, requiring installation of new insulated roof over existing roof, even though cost of repair was disproportionate to additional heating and cooling costs, where homeowners testified heating and cooling problems continued after larger air conditioner was installed, and they were still unable to maintain second level at comfortable temperature.); *see also* Zindell v. Central Mutual Ins. Co. of Chicago, 269 N.W. 327 (Wis. 1936); Aetna Ins. Co. v. 3 Oaks Wrecking & Lumber co., 382 N.E.2d 283 (Ill. App. 1978); Peluso v. Singer General Precision, Inc., 365 N.E.2d 390 (Ill. App. 1977) (reasoning that such recovery will discourage the cutting of corners in meeting code requirements); and A.J. Jacobson Co. v. Commercial Union Assur. Co., 83 F.Supp. 674 (D. Minn. 1949). *But see* Mercer v J. & M. Transp. Co., 103 Ga. App 141, 118 SE.2d 716 (The proper measure of damages was not the cost of restoration, where a 25 to 30-year-old house was totally destroyed, and did not originally have plumbing, wiring, bathrooms, or modern heating, and where the cost of restoration would be far in excess of the difference in value before and after the injury to the premises.).

[25] 639 So. 2d at 597.

[26] Restatement (Second) of Torts § 929 cmt. B (1979); *see also* Kates Transfer and Warehouse Company v. Klassen, 59 So. 355 (Ala. 1912); Carye v. Boca Raton Hotel and Club Limited Partnership, 676 So. 2d 1020 (Fla. 4th DCA 1996); Huberth v. Holly, 462 S.E.2d 239, 243 (NC Ct. App. 1995) ("When, however, the land is used for a purpose that is personal to the owner, the

replacement cost is an acceptable measure of damages."); Plow v. Bug Man Exterminators, Inc., 290 S.E.2d 787, 789 (termite damage to personal residence), *disc. rev. denied*, 294 S.E.2d 224) (NC 1982); Doty v. Parkway Homes Co., 295 S.C. 368, 368 S.E.2d 670 (S.C. 1988); T.M. Nelson v. The Coleman Company, 155 S.E.2d 917 (SC 1967); Younger v. Appalachian Power Co., 202 S.E.2d 866 (Va. 1974) ("When diminution in market value can be reasonably ascertained, that is the appropriate measure of damages; but when the damaged property has no ascertainable market value or when market value would be a manifestly inadequate measure, then some other measure must be applied."); Solite, Corp. v. Richmond, Fredericksburg and Potomac R.R. Co., 1989 WL 646148 (Va. Ct. App. 1989).

[27] Id. at 1021 (quoting Florida Pub. Utils. Co. v. Wester, 150 Fla. 378, 7 So. 2d 788, 790 (1942) and citing McDonald Air Conditioning, Inc. v. John Brown, Inc., 285 So. 2d 697, 698 (Fla. 4th DCA 1973) ("If the item has no market value, such as heirlooms, etc., of necessity other sources must be used to determine value.").

[28] Carye, 676 So. 2d at 1021.

[29] Id. (citing Campins, 461 N.E.2d at 720 n. 1 (burden of establishing lack of market value rests with plaintiff)).

[30] Leonard Missionary Baptist Church v. Sears, Roebuck and Co., 42 S.W.3d 833 (Mo.Ct.App. 2001) (church); Trinity Church v. John Hancock Mutual Life Ins. Co., 502 N.E.2d 532 (Mass. 1987) (church); Commonwealth of Pennsylvania v. Crea, 483 A.2d 996 (Pa. Cmmw. 1997) (bridge); and Newton Girl Scout Council v. Massachusetts Turnpike Auth., 138 N.E.2d 769 (Mass. 1956) (girl scout camp); *see also* Roman Catholic Church of Archdioces of New Orleans v. Louisiana Gas Serv. Co., 618 So.2d 874, 877-80 (La. 1993); Moulton v. Groveton Papers Co., 114 N.H. 505, 323 A.2d 906, 911 (1974); Regal Construction Co. v. West Lanham Hills Citizen's Association, 256 Md. 302, 260 A.2d 82, 84 (1970).

[31] Ocean Electric Company v. Hughes Laboratories, Inc., 636 So. 2d 112 (Fla. 3d DCA 1994); Kaplan v. City of Winston-Salem, 209 S.E.2d 743 (NC 1974). *But see* Ishee v. Dukes Ford Company, 380 So.2d 760 (Miss. 1980) ("The proper measure of tort damages for a plaintiff holding personalty for sale in the retail market is the total diminution in retail market value proximately caused by the defendant's tort. Cost of repair may be recovered, as well as the remaining diminution in pre-tort value after the proposed repairs, but in no event may cost of repair be recovered to the extent it exceeds the total diminution in pre-tort value in the case of one holding personalty for sale rather than for personal use.").

[32] Ocean Electric, 636 So.2d at 116.

[33] Id.

b.

PROOF OF DAMAGES IN SUBROGATION ACTIONS:
PROBLEMS AND SOLUTIONS

I. INTRODUCTION

While there are some minor variations from state to state in the applicable law regarding property damages, the basic principles are universal, to a greater extent than in many other areas of the law. Because of this, and because of the relatively limited amount of case law addressing specific issues regarding the measure and proof of property damages in most jurisdictions, lawyers who handle property damage cases often have the need or occasion to cite and rely upon pertinent precedent from foreign jurisdictions.

A favorite among subrogation practitioners is Lakewood Engineering & Manufacturing v. Quinn, 604 A.2d 535, 539 (Md. App. 1992). In Lakewood, a claim for damages resulting from a fire caused by a defective electric fan, the Maryland Court of Special Appeals not only held that the trial court properly accepted the plaintiff's insurer's estimate of the property damages into evidence, but also upheld the trial court's action in throwing out the jury's damages verdict as inadequate, because the amount of the award represented only a fraction of the insurer's damage estimate. Those who regard the insurance profession as a service industry might be startled by the Lakewood court's statement that "it is the nature of an insurer to pay as little as possible on any given claim", and by the characterization of the insurance company's adjuster as "one whose interests are diametrically opposed" to those of the insured. The Lakewood court concluded:

> In light of the adversarial relationship that generally exists between an insurer and a claimant/insured, an inference may properly be drawn that the amount of damages to which the insurer concedes is, at the very least, the lower boundary of the damage actually suffered.

604 A.2d at 539.

Upon reading the Lakewood decision for the first time, most attorneys who routinely pursue subrogation claims probably pause for a moment and wistfully imagine that the task of proving damages were truly so simple. Lakewood is the only case specifically adopting the notion that subrogating insurance carriers routinely strong-arm their insureds to the point that any amount the carrier ultimately agrees to pay must, of necessity, be regarded as a solid reflection of the minimum damages recoverable from a tortfeasor. In practice, the Lakewood argument must be employed sparingly and selectively, since most liability claims personnel, defense attorneys, judges and jurors will either know intuitively or will readily recognize that, while the amount paid out on a first-party property insurance policy may accurately reflect the amount owed under the policy, the amount of such a payment may bear no relationship - or only an incidental relationship - to the amount recoverable from a third party tortfeasor. In Interested Underwriters at Lloyd's v. Third Holdings, 88 A.D. 2d 863, 451 NYS 2d 759 (First Dept. 1982) the court threw out a property damage award that was based exclusively on the damage

documentation and estimates used to establish the amount of the subrogated insurer's payment to its insured, on the grounds that this information failed to establish the amount recoverable from the tortfeasor under the applicable legal standard. In theory, an insured with a contractual right to recover its damages under a property insurance policy would be expected to extract from the insurer every penny to which the insured is legitimately entitled. Thus, representatives of defense interests can often make a cogent argument that the first-party insurance payment is more meaningful as an indication of the maximum amount that could ever be recovered, rather than serving as the lower limit of the damages that should be recoverable.

This article will discuss the legal standards for proving the amounts recoverable from a tortfeasor for the kinds of damages that are most frequently involved in subrogation claims, and the practical implications of the differences in the legal standards applicable to the measure and proof of damages recoverable in tort and under the first-party property insurance contract.

II. LEGAL STANDARDS REGARDING THE MEASURE AND PROOF OF THE AMOUNTS RECOVERABLE FROM A TORTFEASOR FOR PROPERTY DAMAGES

A. The Basic Measure of Damages to Real Property

1. Pennsylvania Law

In Pennsylvania, "the measure of damages for injury to property is the cost of repairs where the injury is repairable; however, where the injury is characterized as permanent, the measure of damages becomes the decrease in the fair market value of the property". Wade v. S.J.Groves & Sons Co., 283 Pa. Super. 464, 483, 424 A.2d 902, 911 (1981).

The Pennsylvania Supreme Court has defined "market value" as "what a purchaser willing to buy feels justified in paying for property which one is willing but not required to sell". Fedas v. Insurance Company of the State of Pennsylvania, 300 Pa. 555, 562, 151 A. 285 (1930). This is typical of the definition of "market value" that is applied in other jurisdictions. See e.g., Elberon Bathing Company, Inc. v. Ambassador Insurance Company, Inc., 77 N.J. 1, 9, 389 A.2d 439, 443 (1978).

In Babich v. Pittsburgh & New England Trucking Co., 563 A.2d 168, 170 (Pa. Super. 1989), the Pennsylvania Superior Court held that evidence of the cost to repair or replace property was inadmissible where the damage was "permanent" or irreparable. Older Pennsylvania cases, reflecting a more agrarian approach to property valuations, suggested that even the complete destruction of a building or other structure would not be regarded as "permanent" damage to real property. See e.g. Kosco v. Hachmeister, 396 Pa. 288, 152 A.2d 673 (1959); Showers v. U.S., 113 F. Supp. 350, 352 (M.D. Pa. 1953). The rationale of such an approach is that a building is a mere "improvement" to real property, which can always be restored or replaced, and that "permanent" damage occurs only when the property's natural elements become polluted or depleted or otherwise irreparably destroyed.

This approach may have made sense in the days when income from real property ownership was derived primarily from the production of crops, livestock, timber or other natural

and renewable resources. It makes considerably less sense in modern times, when the potential income to be derived from property ownership, and the resultant value of the property, increases with the intensity of the development of the property. In line with the more modern and realistic approach to property valuation, and without even discussing the older line of cases, more recent Pennsylvania Superior Court cases like Babich characterize the complete destruction of a building as "permanent" damage, resulting in the prohibition of consideration of evidence of the cost to repair or replace the property.

Babich leaves a question unanswered that is often of vital importance to subrogating carriers claiming damages to real property in Pennsylvania: in those cases where enough remains of the original structure that it is theoretically and technically possible to "repair" the damaged property, but it is economically infeasible to do so because the cost of repair would exceed the property's pre-loss market value, is evidence of the repair cost admissible as proof of the damages recoverable? In other words, is the "repairability" or "permanence" of real property damage determined on the basis of theoretical possibility or economic reality? As noted previously, repair costs are admissible as proof of the amount of damages recoverable, but only where the property is repairable. Wade v. J.Groves, supra; Babich, supra. Further, even where repair costs are recoverable, the costs of repair may not exceed the pre-loss value of the property. Jones v. Monroe Electric Co., 350 Pa. 539, 39 A.2d 569 (1944). However, if repair costs have properly been admitted as proof of the damages recoverable, the defendant bears the burden of proving that the cost of repair exceeds the property's value. Watsontown Brick Co. v. Hercules Powder Co., 265 F. Supp. 268, 275 (M.D. Pa. 1967) affirmed 387 F.2d 99 (3rd Cir. 1967).

Thus, in a typical subrogation action, where the only information as to the amount of damages to real property that is developed in the course of the first-party adjustment is based upon the costs of repairing or replacing the damaged property, a great deal can ride upon the determination of whether the damage was permanent or repairable. If the damage is deemed repairable, then the subrogating carrier may properly rely upon the repair cost information as proof of the damages recoverable, subject to whatever rebuttal evidence the defense may offer, including evidence that the repair costs exceeded the property's value.

However, if the property is deemed "permanently" or "irreparably" damaged, and the subrogating carrier has offered no evidence of market value in its case-in-chief, then, at least in Pennsylvania, the carrier may well have failed to meet its burden of proof under the Babich rule. See, e.g. Millers Mutual Fire Ins. Co. v. Wildish Const. Co., 306 Or. 102, 758 P.2d 836 (1988), where the Oregon Supreme Court stated that the plaintiffs had "put all their eggs in one basket" by relying exclusively on evidence of replacement cost in a claim involving the complete destruction of their home and, therefore, failed to make out a case that could be submitted to the jury under the applicable "market value" standard.

Where there is any doubt as to the repairability or permanence of the damage, the safest course is to develop and introduce evidence as to the pre-loss market value of the property, with the recognition that this evidence will serve to "cap" the amount recoverable. One source of such evidence would be a qualified real estate appraisal. Another source that may be available in an appropriate case would be a representative of the insured, because the insured is normally

presumed qualified to testify regarding the value of his or her own property. (See Section III. A., below).

The risk that the subrogating carrier may fail to meet its burden of proof may not be all that great in a case where the "repairability" of the damages is legitimately in dispute. Because a defendant bears the burden of proving that repair costs exceed the pre-loss value of the property, the plaintiff should theoretically be permitted to make out its case-in-chief with proof of repair costs alone. The defendant is then free to attempt to prove that the damage is "irreparable" from a practical standpoint, by offering proof that the property's pre-loss market value was less than the estimated repair costs. At that point, there will be evidence in the record supporting an award of damages under either the permanent or repairable approach. This was essentially the ruling made by The Honorable Mark Bernstein of the Philadelphia Court of Common Pleas in the attached Order in USA One BV et al. v. Delmont Fire Protection et al. (the One Meridian Plaza Fire litigation).

2. Other Jurisdictions

Other jurisdictions are generally in accord with Pennsylvania damages law as outlined above, so that similar issues and considerations will arise wherever the claim is being pursued. Many jurisdictions are not as restrictive as Pennsylvania regarding the admissibility of repair costs in cases of total destruction of a building or structure, and instead treat repair costs and market value as equally acceptable alternative means of proving the damages recoverable. Bastian v. Laffin, 54 Md. App. 703, 460 A.2d 203 (1983); Withers v. Ferraro Construction Co., 21 Md. App. 550, 320 A.2d 576 (1974); Regal Construction Co. v. West Lanham Hills Citizen's Association, 256 Md. 302, 260 A.2d 82, 84 (1970); Jacklitch v. Finnerty 96 A.D.2d 960, 466 N.Y.S.2d 774 (1983); Restatement (Second) Torts, § 929. However, subject to the various exceptions noted below, the repair costs recoverable will almost always be limited to the pre-loss fair market value of the property. Bastian v. Laffin, supra. As in Pennsylvania, the burden is normally on the defendant to prove that repair costs exceed pre-loss market value. Kruvant v. Dickerman, 18 Md. App. 1, 305 A.2d 227, 231 (1973); Bastian v. Laffin, supra; City of Oakland v. Pacific Gas & Electric, 118 P.2d 328, 333 (Cal. App. 1941); Jacklitch v. Finnerty, 96 A.D.2d 690, 691, 466 N.Y.S.2d 774, 776 (1983). Thus, in Huff v. Thornton, 287 N.C.1, 231 S.E. 2d 198, 203 (1974) the court stated that the fact that a building repair estimate failed to take any depreciation into account was a matter for cross-examination and might affect the weight, but not the admissibility, of the evidence.

Some jurisdictions treat proof of repair costs as merely an alternative means of proving the diminution in market value resulting from property damage. Colangeli v. Construction Service Company, 233 N.E. 2d 192, 194 (Mass. 1968); Carolina Power & Light Co. v. Paul, 261 N.C. 710, 136 S.E.2d 103 (1964); Jenkins v. Eplinger, 55 N.Y.2d 35, 432 N.E.2d 589 (1982); Fuller v. Martin, 41 Ala. App. 160, 125 So. 2d 4 (1961). "The law recognizes that the cost of repairs has a logical tendency to shed light upon the question of the difference in market value." Richard W. Cooper Agency v. Irwin Yacht & Marine Corporation, 264 S.E. 2d 768, 771 (N.C. App. 198). From a practical standpoint, a prospective buyer of damaged property would presumably deduct repair costs from the price that would have been offered for the property if it were not damaged. In Huff v. Thornton, 23 N.C. App. 388, 209 S.E. 2d 401, 404 (1974) affirmed 287 N.C.1 231 S.E. 2d 198 (1975), the court suggested that repair

costs were a more realistic reflection of damages than a market value appraisal, which is inherently hypothetical and imprecise.

B. Issues Arising From the Proof of Repair Costs

1. Treatment of Depreciation

Where repair costs are presented in support of a property damage claim, liability insurers and defense counsel invariably assert that they only owe for "ACV", or the repair costs minus depreciation. Before conceding this point, the subrogating insurer's representatives should carefully consider the elements of the repairs that are claimed to be subjected to depreciation, and whether those repairs truly enhance the pre-loss value of the property. Certainly, installation of new carpeting and roofing and fresh paint are likely to enhance the value of a property. See e.g. Medford Housing Authority v. Marinucci Bros. & Co., 241 N.E. 2d 834, 837 (Mass 1968), where the court held that the plaintiffs could not recover the full cost of repainting buildings that were blackened as the result of the defendant's release of hydrogen sulfide gas, where the buildings had not been repainted for several years prior to the incident.

On the other hand, replacement of a masonry wall or steel framing with new materials of like kind and quality, while perhaps a theoretical "betterment" to the existing structure, are not likely to materially increase the property's value. There is authority for the recovery of the full cost of repairs without reduction for depreciation or betterment, where the repairs do not materially increase the value of the property over its pre-loss value, even though the new materials may increase the life expectancy of the property or its components. U.S. v. Ebinger, 386 F.2d 557, 560-561 (2nd Cir. 1967). The rationale of the Ebinger decision was that the injured claimant should not be forced to finance a part of the cost of prematurely replacing equipment that will not add to the property's value. Note that the Ebinger argument will only apply in cases of partial loss, where the damaged property is a necessary part of a larger whole, such that the claimant could not "cut its losses" by abandoning the property in exchange for a payment of the property's pre-loss market value. The Ebinger court also stated that it would be "clearly inequitable" to allow recovery of the full replacement cost of components that were scheduled for early replacement.

Similarly, in New Jersey Power & Light Co. v. Mabee, 41 N.J. 439, 197 A.2d 194 (1964), the New Jersey Supreme Court held that the plaintiff electric utility was entitled to recover the full cost of replacing a 20 year old power pole that had an estimated life expectancy of 36 years for accounting purposes. The court noted that there was no basis upon which to conclude that the damaged pole would only have lasted 36 years, or that the new pole would necessarily last that long, and therefore no basis upon which to conclude that the plaintiff was truly deriving any benefit in replacing the pole as a result of the defendant's tortious conduct.

Depreciated "book values" for property as set forth in the insured's tax schedules and other accounting records rarely bear any real world relationship to the actual value or useful life of the property. Because an insured business owner will normally (and properly) depreciate property at the maximum rate permitted under applicable accounting principles and tax law, defense attorneys frequently attempt to seek out depreciation schedules and other tax and accounting records to undermine the values claimed for damaged property. It is questionable

whether such records should even be admissible for this purpose. In Olson & French, Inc. v. Commonwealth, 399 Pa. 266, 160 A.2d 401, 403 (1960), the Pennsylvania Supreme Court stated that "depreciated book value is an arbitrary accounting figure, unrelated to market value, and therefore irrelevant and immaterial to the issue of fair market value."

2. Code Upgrades

A troublesome issue in the first-party context that is beyond the scope of this article relates to whether and under what circumstances upgrades in construction that are required to meet current building codes are recoverable under a property insurance policy. Assuming that a determination is made that such costs are covered in a particular case, the next question may well be whether those costs can then be recovered from the tortfeasor who caused the loss. The obvious argument against such a recovery is that it did not merely put the claimant in the same position as prior to the loss, but in a "better" position.

However, there is authority for the recovery of such costs. Peluso v. Singer General Precision, Inc., 47 Ill. App. 3d 842, 8 Ill. Dec. 152, 365 N.E.2d 390 (1st Dist. 1977). In Peluso, the court suggested that allowing recovery of such expenses would discourage cutting corners in meeting code requirements in connection with property damage repairs. Another argument for recovery of such costs is that such costs normally would not have been incurred at all, but for the loss. Further, in each case, the particular code upgrades should be critically scrutinized to determine whether or not they truly enhance the value of the property.

3. Admissibility of Repair Cost Estimates When Repairs Are Not Actually Performed

There are a few cases which hold that the "diminution in value" standard is the exclusive measure of damages available when the claimant never actually repairs the damaged property, and that repair cost estimates are therefore inadmissible under such circumstances. Wentworth v. Air Line Pilot Association, 336 A.2d 542 (D.C. App. 1975); Lucas v. Bowman Dairy Company, 50 Ill. App. 2d 413, 200 N.E.2d 374 (1st Dist. 1964); Maryland Casualty Co. v. Rittiner, 133 S.2d 172 (La. App. 1961).

Other courts have rejected this arbitrary and illogical rule, recognizing that the law should be concerned with the appropriate measure of damages only, and not with the manner in which the injured party elects to use the monetary damages awarded. General Outdoor Advertising Co. v. LaSalle Realty Co., 141 Ind. App. 247, 218 N.E.2d 141, 152 (1966); Bates v. Warrick, 77 N.J.L. 387, 71 A.1116 (1909). If there is any doubt that repair estimates will be deemed admissible in a particular case, it is imperative that some evidence be presented to satisfy the "diminution in market value" standard.

C. The Measure and Proof of the Amount Recoverable for Damages to Personal Property

As a general rule, the same basic principles and considerations apply to the measure and proof of damages to personal property as apply to damages to real property. Restatement (Second) Torts, §928(a); Guido v. Hudson Transit Lines, 178 F.2d 740, 742 (3rd Cir. 1950) (applying New Jersey law); Williams-Bowman Rubber Co. v. Industrial

Maintenance, Welding & Machining Co., 667 F.Supp. 539, 546-47 (N.D. Ill. 1987); Wambles v. Davis, 405 So. 2d 945 (Ala. Civ. App. 1981); Babbitt v. Maraia, 157 A.D. 2d 691, 549 NYS 2d. 791 (2d Dept. 1992). However, in practice, the "general rule" is often subsumed by various exceptions that apply to much of the damaged property that is frequently involved in subrogation claims. The following is a discussion of the two exceptions that apply with greatest frequency in subrogation actions.

1. Household Effects

Household furnishings, appliances, and clothes are components of virtually any significant homeowner's claim. Strictly speaking, there is a "market value" for such goods, which is best reflected by what a sale of the goods might bring in a yard sale, estate sale, or at a consignment shop. The imposition of a "market value" measure of damages would obviously impose a severe hardship on tort victims who must reestablish their households by purchasing new goods at much higher prices than the market value of the used, but otherwise perfectly serviceable, goods they are being forced to replace. In recognition of this hardship, there is authority in Pennsylvania, New Jersey and most other jurisdictions which rejects a strict "market value" measure of damages with respect to household effects. Instead, the courts favor a more flexible "actual value to the owner" approach that takes into account both the original and replacement cost of the goods, the likelihood and feasibility of replacing the property with comparable equivalents, and other considerations that would affect the property's value to its owner. See e.g., Lloyd v. Haugh & Keenan Storage & Transfer Co., 72 A. 516 (Pa. 1909); Lane v. Oil Delivery, Inc., 216 N.J. Super. 413, 524 A.2d 405 (App. Div. 1987); Jacklitch v. Finnerty, 96 A.D.2d 690, 466 N.Y.S.2d 774 (1983); Holme v. Freeman, 185 A.2d 88, 91 (Conn. App. 1962); Muller v. Sinclair Refining Co., 32 A.D.2d 1000, 301 N.Y.S.2d 716, 718 (1969); DeSpirito v. Bristol County Water Co., 102 R.I. 50, 227 A.2d 782 (1967); Kates Transfer & Warehouse Co. v. Klassen, 6 Ala App. 301, 59 So. 355 (1912). "The rationale for such a rule is consonant with the goal of tort damages to fully compensate the injured party, thereby making it possible to replace the lost property with a comparable substitute." Lane v. Oil Delivery, supra, 524 A.2d at 409.

While the original and replacement cost of the goods may be considered as evidence under the "actual value" standard, the amount recoverable under the standard does not necessarily, or even usually, equate with the full replacement cost of the damaged goods. Muller v. Sinclair Refining Co., supra, 301 N.Y.S.2d at 718. Particularly in the case of property that has a finite useful life, it would not necessarily be any more equitable to require the defendant to pay the full replacement cost than it would be to force the plaintiff to accept the liquidation value of the household effects. This may be one of the rare instances in which "ACV" actually reflects at least a roughly accurate measure of the amount recoverable.

2. Inventory

The measure of damages to an inventory of merchandise is one of the few situations in which the full replacement cost generally equates with the recoverable "market value", particularly where the inventory is the stock of a wholesaler or retailer. Kaplan v. City of Winston-Salem, 286 N.C. 80 (1974). From a practical standpoint, in order to replace damaged stock, the retailer or wholesaler would normally be expected to turn to its suppliers and pay the

then-current price in that market for substitute goods. To the extent that the injured merchant must also pay any expediting expenses or other costs in order to maintain or properly restore normal business operations, those costs, if reasonable, should be recoverable as consequential damages. Restatement (Second) Torts, §§ 927 and 928.

There is authority for a manufacturer to recover the wholesale selling price for damaged products. Simmons, Inc. v. Pinkerton's, Inc., 762 F.2d 591, 606-607 (7th Cir. 1985) (applying Indiana law); H.K. Porter Co. v. Halperin, 297 F.2d 442 (7th Cir. 1961) (applying Illinois law); Restatement (Second) Torts, §911, comment (d). The best rationale for such a recovery is that the only "market" that is theoretically available for the manufacturer to procure replacement goods would be competing manufacturers of the same goods, who would presumably charge at least their wholesale selling price. The subrogating insurer that has been required under its policy to pay its insured manufacturer's selling price will most often benefit from this doctrine in spite of its logical flaw: the rule allows a potential windfall recovery of the "profit" element of the selling price even where the manufacturer was able to procure replacement goods from its own production or inventory without incurring any actual loss of sales or profits. However, unincurred costs associated with the sale of the goods, such as salesmen's commissions, will have to be deducted from the wholesale selling price. Simmons, Inc. v. Pinkerton, supra.

While there are no Pennsylvania or New Jersey decisions to this effect, some courts have even allowed a retailer or wholesaler to recover the selling price of destroyed goods. Tozzi v. Testa, 97 Ill.App.3d 832, 53 Ill. Dec. 379, 423 N.E.2d 948 (3d Dist. 1981); Winfield Design Associates, Inc. v. Quincy Jefferson, 581 F. Supp. 21 (N.D. Ill. 1984). Such a ruling is even more difficult to support from a logical standpoint, since a retailer or wholesaler can, in many, if not most instances, avoid a loss of sales from destroyed inventory by drawing upon other available inventory or through the purchase of replacement goods. In those cases where the particular nature of the goods involved or customer requirements or other circumstances result in an actual loss of sales, there should be independent evidence to establish that the loss of sales occurred. Where an actual loss of sales occurs, full selling price should be recoverable to reflect the loss of profits, minus any costs of sales that were not incurred.

D. Unique Property and the "Peculiar Value" Doctrine

Another broad exception to the market value measure of damages applies where property — real or personal — has no market value, or where the "fair" market value does not accurately reflect the true value of the property to its owner. Examples of circumstances in which the unique property or "peculiar value" exception has been applied includes cases involving damage to bridges (Commonwealth v. Crea, 483 A.2d 996 (Pa. Cmwlth. 1977)), churches (Trinity Church v. John Hancock Mutual Life Ins. Co., 399 Mass. 43, 502 N.E.2d 532 (1987)) and historically or architecturally unique structures (Klair v. Day, 1988 W.L. 4756 (Del.Super. 1988)). Electrical utility poles are likely candidates for property damage and are also a fertile source of case law regarding the proper measure of damage to property with no "fair" market value. See e.g., Duquesne Light & Power Co. v. Rippel, 478 A.2d 472 (Pa. Super. 1984); Carolina Power & Light Co. v. Paul, 261 N.C. 710, 136 S.E.2d 103 (1964).

A slightly different articulation of a similar principle provides that where an injured property owner demonstrates a "reason personal" for restoring the damaged property to its original condition, the property owner may recover the full cost of restoration, even though this cost may exceed the pre-loss value of the property. Heninger v. Dunn, 101 Cal. App. 3d 858, 162 Cal Rptr. 104 (1980); Regal Construction Co. v. West Lanham Hills Citizen's Association, 256 Md. 302, 260 A.2d 82, 84 (1970); Restatement (Second) Torts, §929, comment (b). For example, in State v. Rice, 24 Md. App. 631, 332 A.2d 296 (1975), the court held that a property owner's desire to replace wrongly felled trees for the purpose of providing privacy to the land was sufficient "reason personal" to affirm the judgment of $17,500 for replacement of the trees, even though an appraiser had testified that the diminution in property value was only $100.

Thus, by persuading a court that the "unique property" or "peculiar value" or "reason personal" doctrines should be applied, many potential problems in proving damages in subrogation actions may be solved, because the doctrine opens the door to proof of damages by way of the cost of repair or replacement estimates that are typically developed in the course of the first-party adjustment. However, the doctrine is truly an exception to the general rule, and will not be applied in cases involving typical residential or commercial properties, for which a fair market value is presumed to exist.

E. Business Interruption and Lost Rentals

1. The Basic Standards for Measuring and Proving Loss of Income

The phrase "business interruption" is virtually exclusively an insurance concept. The tort law analogue to a claim for "business interruption" is a claim for "lost profits" or "loss of income." Such damages fall within the broader category of "consequential damages." An action for loss of income or for the loss of use of property is allowed where such loss is caused by the claimant's inability to use property due to the defendant's wrongful conduct. Kosco v. Hachmeister, Inc., 396 Pa. 288, 152 A.2d 673 (1959); Neville Chemical Co. v. Union Carbide Corp., 422 F.2d 1205, 1226 (3d Cir. 1970). To recover, the claimant's profits must have been lost as a result of the defendant's tortious conduct. Cromartie v. Carteret Savings & Loan, 277 N.J. Super. 88, 103, 649 A.2d 76, 83 (App. Div. 1994). "Lost profits" are defined as the difference between gross income and the cost or expenses which would have had to be expended to produce that income. Cromartie, supra. The party claiming the damages must prove the relevant expenses or show that the inability to produce the proof is a consequence of the defendant's actions. Cromartie, supra.

Lost profits must be computed on a reasonably accurate and fair basis. J.L. Davis & Associates v. Heidler, 263 N.J. Super. 264, 276, 622 A.2d 923, 929 (App. Div. 1993). Thus, a claim for lost profits may be rejected as speculative and unrecoverable where made in the context of a new and untried business venture. International Control Corp. v. National Semi-Conductor Corp., 833 F.2d 491 (3d Cir. 1987); Grossberg v. Judson Gilmore Associates, Inc., 196 Ga.App. 107, 108, 395 S.E.2d 592, 594 (1990); Coastland Corp. v. Third National Mortgage Co., 611 F.2d 969, 978 (4th Cir. 1979).

Within these broad parameters, there are not a great many hard and fast rules concerning the proper method of proving such losses. The flexibility of the courts in this regard reflects a recognition that proof of a loss of income claim necessarily depends upon proof of a purely hypothetical scenario: what would have happened if the injury had not occurred. While it is necessary to prove the damages with reasonable certainty, the claimant is not necessarily required to document every cancelled order or present each prospective customer who would have purchased products or services from the claimant, but did not, as a result of the loss.

Rather, the claimant need only provide some evidentiary basis for the award of lost profits. Franklin Music v. American Broadcasting Companies, 616 F.2d 528, 546 (3d Cir. 1979); Computer Systems Engineering, Inc. v. Qantel Corp., 740 F.2d 59, 67 (1st Cir. 1984); Batterman v. American Stores Co., 67 Pa. 193, 80 A.2d 66, 74 (1951); In re Knickerbocker, 827 F.2d 281, 288 (8th Cir. 1987). "Where there is a basis in the evidence for a reasonable computation of the damages suffered considering the nature of the transaction, a verdict may be based thereon, though there may be involved some uncertainty about it. Weinglass v. Gibson, 304 Pa. 203, 155 A. 439, 440 (1931).

The generally accepted evidentiary standard for proof of lost earnings in a tort action is set forth under comment (d) to Restatement (Second) Torts, §912, which states, in pertinent part:

> Although the burden is on the injured person to prove with a fair degree of certainty that the business or transaction was or would have been profitable, it is not fatal to the recovery of substantial damages that he is unable to prove with definiteness the amount of the profits he would have made or the amount of harm that the defendant has caused. It is only essential that he present such evidence as might reasonably be expected to be available under the circumstances. Restatement (Second) Torts, §912, comment (d); (emphasis supplied).

accord, ABC-Paramount Records, Inc. v. Topps Record Distributing Co., supra, 374 F.2d 455, 461 (5th Cir. 1967); Bangor Punta Operations, Inc. v. Universal Marine Co., Ltd., 543 F.2d 1107, 1110 (5th Cir. 1976); Page County Appliance Center v. Honeywell, 347 N.W. 2d 171, 178 (Iowa 1984) (tax return showing decreased earnings was alone deemed sufficient evidence of damages caused by defendant's tortious conduct). Even where the claimant cannot demonstrate a history of profitable operations, lost profits may nevertheless be recovered if the claimant can establish that there was a pre-loss trend toward profitability. Novatel Communications v. Cellular Telephone Supply, Inc., 856 F.2d 151 (11th Cir. 1988). Expert testimony can often supplement, or even supplant, proof of the claimant's actual earnings and profitability history, and provide the required evidentiary basis for an award of lost profits. In re Knickerbocker, 827 F.2d 281, 288 (8th Cir. 1987).

The evidentiary standards for proof of lost profits are generally flexible enough to permit the utilization of the data developed in the course of the adjustment of a first-party business interruption loss. With a few exceptions, the same legal principles that would limit or preclude a recovery under the tort measure of damages would have the same effect upon the amount recoverable under the business interruption provisions of the policy. Therefore, differing legal standards under tort law and under the terms of the insurance contract are not the most

frequent source of problems in proving such claims. Rather, the difficulties tend to arise from the vagaries of the different environments in which the claims are presented and resolved.

As an example, consistent with the goal of properly and equitably resolving the policyholder's claims, business interruption claims are often adjusted on the basis of projected revenue losses during the projected suspension periods that have not expired by the time the adjustment is concluded. On the other hand, even the longest periods of business suspension will likely have ended before the time comes to prove the revenue loss in a subrogation action. At that point, the loss projections developed in the adjustment process are of merely academic interest to the opposing party, who will be seeking evidence demonstrating that an actual revenue loss either did or did not occur. Due to circumstances that could not reasonably have been anticipated by the insurer or insured during the adjustment process, it may well turn out that the actual period of business suspension was significantly shorter than projected, or even that there was no provable loss during the projected suspension.

For instance, when a property loss shuts down the production line of a plant working at full capacity to fill a backlog of orders, the adjustment of the business interruption loss may be premised upon the assumption that each day of lost production translates into a loss of profits on the goods that would have been produced on that day. However, an unexpected downturn in the insured's market, even one happening months after the occurrence of the casualty, may free up some of the insured's manufacturing capacity so that the insured is ultimately able to "make up" the lost production with no loss of sales.

The insidious impact that the passage of time between the occurrence of the loss and the adjustment and the presentation of the subrogation claim can have on the damages recoverable can also manifest itself in other ways. For instance, the insured may retain damaged inventory with a credit applied against the loss amount for the inventory's "salvage" value and later there may be no evidence that the insured actually sold the goods at a reduced price. Another example is an insured who cannot produce actual repair bills approaching the amount of the repair estimates utilized to establish the adjusted property loss.

The opposing party's legitimate, but nevertheless aggravating, interest in actual as opposed to projected revenue losses and other damages data gives rise to another problem. Generally, the opposing party will request in discovery financial information regarding the insured's operations both prior to and following the loss. While such information may be directly germane to the damages claimed in the subrogation action, it likely was not requested during, and was not even germane to, the first-party adjustment process. The sensitive nature of this information, not to mention the sheer burden of assembling it, often means that complying with legitimate discovery requests pushes the insured's cooperation obligations to the absolute limit. The best practical solution is to enter into a pro-ration agreement with the insured whenever possible so that the insured has some financial stake in the success of the subrogation effort, to the extent of the insured's legitimate uninsured losses.

2. The Recoverability of Consequential Damages in Total Loss Situations

Where there is a claim for lost rentals, there is at least an issue whether the lost rentals can be recovered when the rental property was totally destroyed. Sandoro v. Harlem-

Genesee Market, 105 A.D.2d 1103, 482 N.Y.S.2d 165 (1984). A similar issue can arise with respect to a claim for loss of use of totally destroyed property. American Jet, Inc. v. Leyendecker, 683 S.W.2d 121 (Tex. Civ. App. 1984); Cowhey v. Dornhaffer, 47 D&C 2d. 190, 193 (Mercer County Pa. C.P. 1969); Anno 18 ALR 3d 497, §8. The rationale for precluding the recovery of lost rentals or loss of use damages is that a property's capability to generate income is reflected in its market value, so that an award of damages that includes both the full value of the property as well as damages for loss of income or loss of use represents a double recovery. See also Babich v. Pittsburgh & New England Trucking Co., 563 A.2d 163 (Pa. Super. 1989), where the court refused to allow an owner of a building occupied for business purposes to recover consequential damages in the form of lost revenues and rental costs incurred for substitute space after the building was destroyed by the defendant's truck, on the grounds that such losses were not compensable when the damage to the property was permanent.

The theory behind precluding recovery of consequential damages apparently assumes that one whose income-producing property is totally destroyed can and should immediately procure replacement property to avoid interrupting the income stream. However, the exclusion of consequential damages in a total loss situation fails to recognize that, until the defendant actually pays the claimant the money reflecting the value of the destroyed property, the injured party will effectively be deprived of the value of the property. Thus, the argument for exclusion makes sense only in jurisdictions, like New York, where prejudgment interest is available from the date of a property loss, (See New York C.P.L.R. §§5001 and 5004), and then only when a replacement for the destroyed property is readily available. (Note that New York law only allows a subrogated insurance carrier to recover prejudgment interest from the date of the payment to its insured. American Home Insurance Co. v. Morris Industrial Builders, Inc., 192 A.D.2d 477, 597 N.Y.S.2d 27 (1st Dept. 1993)).

Other jurisdictions have rejected the argument that no damages for loss of use of property can be recovered in total loss situations, at least for the period reasonably required to replace the property. Dennis v. Ford Motor Co., 471 F.2d 733, 736-37 (3d Cir. 1973) (predicting Pennsylvania law); Huff v. Thornton, 287 N.C.1, 213 S.E. 2d 198, 204 (1975); Reynolds v. Bank of America, 53 Cal. 2d 49, 345 P.2d 926 (1959); Bartlett v. Garrett, 130 N.J. Super 193, 325 A.2d 866 (Dist. Ct. 1974); Louisville & I.Ry. Co. v. Schuester, 183 Ky. 504, 209 S.W. 542 (1914); Guido v. Hudson Transit Lines, 178 F.2d 740 (3d Cir. 1950) (applying New Jersey law); Artech Service, Inc. v. MacDonald Construction Co., 150 So.2d 465 (Fla. App. 1963); Allanson v. Cummings, 81 A.D. 2d 16, 439 N.Y.S. 2d 545 (4th Dept. 1981); Anno. 18 A.L.R. 3d 497, §§9-11.

F. Extra Expense and Additional Living Expense

Subject to the potential issue discussed above regarding the preclusion of an alleged "double recovery", extra expenses (in the case of losses involving commercial policyholders) and additional living expenses (in the case of homeowners) are generally recoverable as consequential damages. Restatement (Second) Torts, §§927 and 928(b); Huff v. Thornton, 287 N.C.1, 213 S.E. 2d 198, 204 (1975). Such expenses are subject to standards of economic and commercial reasonableness.

III. OTHER "CATCH-ALL" SOLUTIONS

Of course, there is not always a solution to every damages problem. In some cases, the differing legal standards or the simple non-existence of competent evidence of damages under the appropriate legal standard will preclude recovery in a subrogation action of at least a portion of the amount paid under the first-party policy, even in a case of clear liability. As noted previously, the "unique property" or "peculiar value" doctrine can serve as a basis for proving and recovering damages from a tortfeasor based upon the information developed as a result of the first-party adjustment. By definition, however, not every property can be "unique."

There are a couple of other strategies that can help in many cases. These include using the testimony of the insured to prove the amount of the loss, and the use of motions to bifurcate the liability and damages issues in a subrogation action.

A. Utilizing the Testimony of the Insured as to the Value of the Property

Virtually every jurisdiction recognizes that a property owner is presumed to be competent to testify as to the value of his or her own property. Silver v. Television City, Inc., 207 Pa. Super. 150, 205 A.2d 335 (1965); Lane v. Oil Delivery, Inc., 216 N.J. Super. 413, 524 A.2d 405, 409 (A.D. 1987); Tulin v. Bostic, 152 A.D.2d 887, 544 NYS 2d 88, 89 (2d Dept. 1989); Brannon v. State Roads Commission, 305 Md. 793, 506 A.2d 664 (1984); Birmingham Railway, L&P Co. v. Hinton, 47 So. 576, 157 Ala. 630 (1908). This doctrine authorizes property owners to offer "lay opinions" regarding the value of their property, even when they lack the normal qualifications for opinion or "expert" testimony. The doctrine presumes that a property owner will normally have sufficient familiarity with the property to provide at least minimally useful information as to its value.

This doctrine can be useful in those instances where there is no other available proof of the damages under the appropriate legal standard, or where it is necessary to bootstrap the information developed in the course of the first-party adjustment into something that would be admissible as proof of the damages recoverable in the third-party tortfeasor context. The doctrine may also prove useful in those instances where the subrogation litigation has proceeded in the name of the insured and there would be no other way to prove damages at trial and continue to keep the insurance company's interest in the background.

However, there are many reasons why utilization of the insured's "lay opinion" on damages will not work or should not be attempted in particular cases. For example, the insured may be reluctant, unwilling or simply unable to provide the required evidentiary support. Invocation of the cooperation provisions of the policy obviously will not be effective to compel the insured to hold an opinion which he or she simply does not have. Further, in some cases, the insured really may not have any basis for offering an opinion as to the value of his or her property. It is obviously critical not to place the insured in a potentially embarrassing situation, not only for the insured's sake, but also from the standpoint of avoiding alienating the jury.

Finally, the insured's opinion often may not be as persuasive as an independent, objective appraisal of the amount of loss, particularly where the opposing party is expected to offer such an appraisal. Thus, reliance upon the insured's opinion is best used in cases involving

homeowner's personal property claims and other relatively straightforward claims as well as other situations where the insured truly is in the best position to know the value of the property. The insured may also be a good resource in those instances where a major dispute on damages is not really expected, but there is concern about establishing a prima facie case on damages under the applicable legal standard.

B. Bifurcation Motions

Strictly speaking, the typical ruling granting a motion for bifurcation, providing that liability issues will be tried separately from and prior to damages issues, technically only has the effect of deferring whatever problems may exist in the proof of the damages aspect of the case, and possibly only for a very brief time. However, from a practical standpoint, it is remarkable how a bifurcation ruling, particularly if granted early in a case, can serve to defuse potentially problematic damage issues. The bifurcation order will frequently have the effect of shifting the opposing party's focus away from the damages issues during the trial preparation stage, and enhance the natural tendency to regard the liability issues as the primary, if not exclusive, battleground. If the case has to be tried, a favorable outcome during the liability phase may well cause any lingering dispute regarding the damages issues to evaporate. If a settlement cannot be negotiated following the liability phase, a favorable outcome on the liability issues may at least pave the way for some form of alternative dispute resolution, which is generally more receptive to proof of damages via the methods and documentation commonly used in the insurance industry.

Another major benefit of bifurcation is that it normally permits the subrogated insurer's interest in the case to be excluded from the jury during the trial of the critical liability issues.
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C.

RCV AND ACV INFORMATION

FOR

COZEN O'CONNOR

2007 ROCKY MOUNTAIN

SUBROGATION SEMINAR

August 22, 2007

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I. Replacement Cost Value (RCV) Definitions

Replacement Cost is defined by Marshall & Swift, LP's Valuation Service as:

> *"The replacement cost of a building is the total cost of construction required to replace the subject building with a substitute of like of equal utility using current standards of material and design. These costs include labor, materials, supervision, contractors profit and overhead, architects' plans and specifications, sales taxes and insurance."*

Value is defined in Webster's Ninth New Collegiate Dictionary as:

> Noun: "The monetary worth of something."
>
> Verb: "To estimate or assign the monetary worth of something."

II. Evaluation of RCV for Insurance Purposes

Marshall & Swift, LP's Valuation Service states the following regarding **value**:

> *"In establishing concepts of value, the first criterion of the reliability of any concept is its supportability. It should allow the estimate of value to be based on logical evidence and actual fact that can be supported by documentation. All items considered as indicators of value must have a firm foundation in fact. Therefore, replacement or reproduction cost figures used in valuation should be established by the action and reaction of the market and should reflect all factors that go into that market."*

Steps Taken to Develop RCV Estimate

1. **Document Loss & Damages**
   - Site inspection taking detailed notes on measurements, materials, systems etc.
   - Photograph and video – pre-loss and post-loss.
   - Obtain blueprints/plans where possible.
   - Identify damaged materials and components.

2. **Develop Scope of Repair**
   - Identify damaged components.
   - Identify economies of repair vs. replacement – per component and/or per project.
   - Identify/separate code upgrades.

3. Quantify Scope of Repair by Trade

Sample areas include:

- Demolition
- Site-work
- Earthworks
- Foundations
- Superstructure
- Exterior Finishes
- Interior Finishes
- Specialty Equipment & Systems
- Mechanical Systems
- Electrical Systems
- Plumbing Systems

Locations include different sections of buildings or rooms.

4. Pricing

- Identify what the most appropriate type of contractor to perform repairs and whether repairs or replacement will be performed by project manager, general contractor, specialty contractor etc.
- Research labor pricing for the various building trades in that region.
- Research contractor mark-ups for general conditions, overhead and profit.
- Research source, availability and pricing of materials and equipment.
- Estimate production – unit man hours, man days etc.
- Identify factors effecting pricing and production for that project and region – availability of labor; remote location; tough working conditions; availability of area to work in; acceleration; regulatory agencies etc.
- Apply pricing to scope of work for repair or replacement taking all factors into consideration.

III. Other Methods to Evaluate RCV

The following are alternative ways to evaluate RCV:

1. **When Repair/Replacement Work is Complete.**
    - Review and evaluate scope of repair/replacement by obtaining as much information from owner, adjuster, architect, engineer, contractor etc.
    - Evaluate actual costs for repairs or by developing independent RCV estimate or by evaluating actual costs. Obtain and evaluate actual costs including: agreement between owner and contractor for work performed, daily timesheets for workers, confirmation of wages/salaries paid to workers, invoices for material, equipment and subcontractors, cancelled checks showing payments etc. Obtain documentation from contractor such as daily records, meeting minutes etc.

2. **When Repair/Replacement Work has not Started**
    - Develop scope of repairs – preferably by using an experienced professional such an architect, engineer, estimator etc.
    - Competitively bid the repair/replacement work to qualified contractors.

- Evaluate proposals/estimates from contractors by performing a detailed review of scope of work included – make sure there is a written confirmation of scope of work included; interview contractor etc.

- Install management procedure to monitor the work – make sure contractor's payment requests are accurate and in line with work performed; changes in work are inspected and documented etc.

3. On Site Project Management & Repair/Replacement Performed on a Time and Materials Basis

- Identify qualified contractor to perform the repairs/replacement work.

- Review and agree on rates and compensation for units of work to be performed.

- Develop scope of work as described above or as uncovered on site using experienced professionals such as architects, engineers, estimators etc.

- Monitor the work onsite on a daily basis either on a part time or full time basis.

IV. Actual Cash Value (ACV) Definitions & Terminology

Actual Cash Value (ACV) is simply defined as **Replacement Cost Value less Depreciation.**

Depreciation is defined by Marshall & Swift, LP's Valuation Service as:

> *"**Depreciation** is loss in value due to any cause. It is the difference between the market value of a structural improvement or piece of equipment and its reproductive or replacement cost as of the date of valuation."*

The factor one should use in evaluating ACV for insurance purposes is defined by Marshall & Swift, LP's Valuation Service as:

> *"**Physical depreciation** is loss in value due to physical deterioration."*

Other factors that effect depreciation are defined by Marshall & Swift, LP's Valuation Service as:

> *"**Functional** or technical obsolescence is loss in value due to lack of utility or desirability of part or all of the property, inherent to the improvement or equipment. Thus a new structure or piece of equipment may suffer obsolescence when built.*
>
> *External, locational or economic obsolescence is loss in value due to causes outside the property and independent of it ..."*

Some important **terminology** used in evaluating ACV includes:

Effective Age is defined by Marshall & Swift, LP's Valuation Service as:

> *"**Effective age** of a property is its age as compared with other properties performing like functions. It is the actual age less the age which has been taken off by face-lifting, structural reconstruction, removal of functional inadequacies, modernization of equipment etc. It is an age that which reflects a true remaining life for the property, taking into account the typical life expectancy of buildings or equipment of its class and its usage. It is a matter of judgment, taking into consideration all factors, current and those anticipated in the immediate future, into consideration. Determination of effective age of older structures may best be calculated by establishing a remaining life which, subtracted from a typical life expectancy, will result in an appropriate effective age with which to work. Effective age can fluctuate year by year or remain somewhat stable in the absence of any major renewals or excessive deterioration."*

Extended Life Expectancy is defined by Marshall & Swift, LP's Valuation Service as:

> *"**Extended life expectancy** is the increased life expectancy due to seasoning and the proven ability to exist. Just as a person will have a total normal life expectancy at birth which increases as he grows older, so it is with structures and equipment."*

Remaining Life is defined by Marshall & Swift, LP's Valuation Service as:

*"**Remaining life** is the normal remaining life expectancy. It is the length of time the structure may be expected to continue to perform its function economically at the date of the appraisal."*

Percentage good is defined by Marshall & Swift, LP's Valuation Service as:

*"**Percentage good** equals 100% less the percentage of cost represented by depreciation. It is the present value of the structure or equipment at the time of appraisal, divided by its replacement cost."*

V. Approaches to Evaluating Depreciation

Straight Line (Age/Life) Approach to Depreciation

The straight line approach includes estimating a life expectancy and depreciating the replacement cost value based on its age, i.e., a constant rate of depreciation is assumed such that the building or equipment would be depreciated 100% at the time it reaches its estimated life expectancy.

This is unrealistic as depreciation is not effected solely by age but also by condition and use.

Mid Life Theory Approach to Depreciation

The mid life theory takes into account that most buildings depreciate very little in their early age. However, there becomes a point in time that a building will start to show its age, maintenance costs increase and the building will start to depreciate at a quicker rate. After several years the building will reach its mid life, and, if the building has been well maintained and is structurally sound, the depreciation remains constant.

Again, this approach is unrealistic as maintenance generally increases in scope and cost in order to maintain the same appearance, use and function.

Extended Life Approach to Depreciation

This approach assumes that building age much the same as people and that the older they get the greater is their total life expectancy. This approach assumes that a building is at its prime at mid life, and it is all downhill from there with the exception that the replacement of components may lower the effective age and extend its remaining life. This method assumes the life of a building would extend similar to a person having a heart transplant in order to extend one's life. The extended life approach assumes that if the process of renovation and replacement of components continues it will periodically reverse the continuous depreciation to its effective age, thereby reducing the depreciation percentage as components are replaced through the building's lifetime.

Again, this becomes unrealistic as eventually more and more components in the building begin to deteriorate, break down or become obsolete and major renovation and replacement costs increase to a point where it becomes no longer practical to invest an enormous amount of money into an old building, especially when you consider the effect on its use and function.

Age and Condition Approach to Depreciation

Marshall & Swift, LP's Valuation Service states that using a combination of age and condition is the best approach to depreciation:

> *"While age is a critical factor, the best approach to the physical depreciation estimate is a combination of age and condition. The observed condition of each component subject to wear is estimated relative to a new condition. A major replaceable component, such as a HVAC system under heavy loading in a hot, humid climate, can wear out quite rapidly, shortening the life expectancy before replacement, while many other portions of a structure, such as excavations, foundations and concrete exterior walls, wear out slowly if at all. Such long-lived portions often represent a major portion of the total reproduction cost and if still functional will contribute toward an extended life expectancy. Physical depreciation cannot be considered a straight-line deduction from reproduction cost, since necessary and normal maintenance can offset, retard and, in some cases, even eliminate deterioration."*

How to Use the Age and Condition Approach to Depreciation of Buildings

1. Research the age of the building as well as the date of renovations, additions or replacement. Try and obtain evidence such as building permit records and copies of invoices from contractors for work performed on the building.

2. Separate the RCV estimate scope and costs into the different trade sections such as Construction Specification Institute (CSI) trade sections or into such sections as Demolition, Site-work, Foundations, Superstructure, Exterior Finishes, Interior Finishes, MEP Systems etc. It may be necessary to breakdown and separate the scope and costs for a component especially if a portion of a building was replaced or an addition was made during its lifetime.

3. Use reputable life expectancy guidelines such as those found in Marshall & Swift, LP's Valuation Service or other life cycle tables found in architectural and engineering reference books – whichever is more appropriate and identify or estimate the **life expectancy** of each component.

4. Estimate the **remaining life** of each of the components based on its quality, age and condition. This can be done by evaluating the combination of the quality of construction or materials used, age of the component and its condition relative to a new condition. Good questions to ask yourself when estimating the remaining life is: "How long can this component last without having to have a major renovation or replacement?" and, "How heavily used or exposed to

the elements was this component?" For example, a asphalt shingle roof should be expected to last longer in a mild climate compared to an extreme climate with major temperature swings and higher exposure to ultra violet rays, such as at high altitude. Another good example would be a second residence which is only used two weeks a year or only on week ends – items such as the interior finishes can be prorated according to their use.

5. The percentage depreciation of each component is then evaluated by subtracting the estimated remaining life from the life expectancy and dividing it by its life expectancy – expressed as a percentage by multiplying by 100.

6. The depreciation value is obtained by multiplying the percentage depreciation to the replacement cost value of each components.

7. The actual cash value of each component is evaluated by subtracting the depreciation value from the replacement cost value.

8. The total depreciation for the direct costs of construction should be evaluated and expressed as a percentage of the total direct costs and applied to general conditions, contractor's overhead and profit, permit fees, architectural and engineering fees etc. in order to evaluate the actual cash value for these items.

9. The total actual cash value is the replacement cost value less depreciation for all items that make up the value of the building.

VI. Questions, Discussion and Notes

- How does Reproduction Cost affect ACV?
  - For instance, redwood framing, plaster finishes, knob and tube wiring or built-in antique cabinetry.
  - Exact replica or functional equivalent

- Can items such as demolition, debris removal or cleaning be depreciated?

- Should the repair of a spalled or corroded surface of a concrete slab be depreciated?

- Do code upgrades affect ACV calculations?

VII. Exhibits

A. Spreadsheet: ACV Calculation - *Section 8 Apartments*

B. Spreadsheet: Detailed Depreciation Calculation

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