



# Damages Proof in Subrogation Cases

## DON'T TAKE IT FOR GRANTED

By Hobart M. Hind, Jr., J.D.

In the past few years, savvy defense lawyers have taken a more inquisitive approach on the valuation of subrogation damages across all lines of insurance.

Gone are the days of assuming the damages must be right because no carrier wants to pay more than they

should. Recently, a more laser-like *Daubert* level analysis has been used to attack the expert proof issues that apply to damages just as they would to a liability claim. A subrogating carrier or outside counsel that takes damages proof for granted may regret it.

### Structural Damages

The basic rule of proof for damages to buildings or structures involves the ability to recover the fair market value of the structure or the cost to repair it, whichever is less. Sometimes the decision early on in the claim might be agreed to by the adjuster and insured before different valuations are undertaken.

Later, the defense may attempt to show that under the “other analysis” the result would have been much less, and that lower number should be your provable damages amount. Just as worrisome would be if your damages experts were not allowed to testify because their analysis was not based on the proper measure of damage.

An expert appraiser may be engaged to inspect the property to provide a valuation of the building later on if the original valuation is challenged. While a company may not want to spend \$20,000 on a full-blown analysis, it can be worthwhile to invest \$2,500 to document the building before it was torn down or altered.

For residential claims, a similar analysis applies. Remember that online residential valuation tools typically include the value of the land, so to establish an accurate damages number, one must factor that out. It is not uncommon to see very large “deltas” between the insured value of a house and its fair market value minus the value of the land. To properly value a structural damages claim, subrogation professionals must consider everything.

### Business personal property/ contents damages

In property subrogation, one of the most difficult damages situations to handle involves a commercial loss where older equipment that is integral to the operation of a facility is destroyed. Oftentimes, the business decision is made to replace used equipment with new equipment to minimize the downtime and associated business income loss. A recent Texas case shows why persistence can pay off.

In *Factory Mutual Ins. Co. a/s/o Veolia v. Alon USA L.P.*, WL 257134 (5th



Cir. 2013), Factory Mutual Insurance Company (“FM”), was awarded damages stemming from an industrial accident that destroyed a waste treatment plant at an oil refinery plant owned by Alon. It relied on the equipment and services of a third party, Veolia North America–West (“Veolia”), for on-site water treatment and waste management. The equipment located in the waste treatment facility (known in the lawsuit as the “the Scalfuel facility”) was owned and operated by Veolia and insured by FM. One day, a cloud of vapor exploded at the Scalfuel facility, destroying it. Veolia filed a claim with

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FM in the amount of \$6,106,880, which FM paid. Thereafter, FM filed a subrogation claim against Alon to recover damages stemming from the explosion.

Before the bench trial began, Alon stipulated to liability, leaving only the issue of damages to be determined.

At trial, the parties agreed that damages would be determined by the fair market value of the Scalfuel plant before the explosion, but they disagreed as to how fair market value should be calculated. FM contended that it was entitled to the Scalfuel plant’s replacement cost, i.e., the cost of new parts and labor adjusted downward to account for the original plant’s depreciation at the time of the explosion. Alon argued that FM was only entitled to the fair market value of the Scalfuel plant’s component parts. FM sought \$6,106,880, whereas Alon claimed FM could only recover \$877,882.

The district court found that even though there was a market for specific used components, there was no market for used Scalfuel systems. Since the sum price of a Scalfuel

system’s components does not reflect the full value of an operational Scalfuel plant, the district court found that the fair market value is determined by the replacement cost adjusted for improvements in value beyond the destroyed plant and depreciation reflecting the remaining useful life of the plant before its destruction.

Accordingly, the district court found Alon liable for \$3,790,391.96, plus interest. To reach this figure, the district court started with an estimate for new equipment, including taxes and shipping, of \$2,356,110. Ten percent was added to this amount as a contingency. The combined sum was then multiplied by 2.25 to account for the costs of installation, testing and startup, and the result was then multiplied by 0.65 to account for the original Scalfuel plant’s 35 percent depreciation.

#### **Business interruption damages**

Probably no area of damages proof is subject to attack as much as the business loss analysis. The analysis can vary depending on the nature of the business: a mom and pop hardware store involves a much more simplistic analysis than a biofuel producer who has operations affected in one location, causing derivative problems in other locations, but still having “make-up capacity” in yet other locations.

Oftentimes, subrogation counsel also represents the insured (subrogor) for their uninsured damages. This could be simply the deductible or it could include elements of the claim for which the insured was underinsured. It could also include business damages that extend well beyond the period of



restoration, which the policy may use to trigger the cut-off of business interruption damages. Counsel must assess these damages too, and if supportable, add them to the claim as uninsured damages.

We have also seen claims where the business interruption claim is calculated using less than a company's full financial documentation, and if the claim is sizable, the defense will ask for all relevant documents to show the actual lost profits is far less than claimed.

To mitigate claims expenses, some companies are using in-house accountants to assess the business losses. This may work out favorably, however no one should be surprised by a request to retain an outside forensic accountant to re-calculate the numbers later on in litigation.

Also, an accountant is a more traditional expert who may be more readily scrutinized by a court than other potential damages experts. For this reason, it is crucial that the plan for business damages proof is mapped out early, preferably with the expert using a *Daubert*-like analysis based upon the full complement of damages support materials from the insured.

### Why does this matter?

Effective subrogation is far more than simply getting as much money back as possible, it involves the return on investment. When a loss happens, there are a set of facts that will play out in a percentage range of liability success (or failure). The range may be 20-30 percent or it may be 65-70 percent, but there will always be a range.

Applied against that range is the cost to get to that point. If the insurer applies the cost of recovery against a total paid claim of \$750,000, an investment of \$50,000 for experts and anticipated litigation costs might make sense. However, failure to analyze the damages properly may result in a recoverable claim of \$475,000, and suddenly, the \$50,000 investment starts to feel a

bit bloated.

There are a host of issues that can plague any case, so don't let poor damage assessments be another one. Doing this well will speed up the case as a whole, and will ease the decision-making for everyone concerned. 🍷

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