



## JUST WHEN YOU THOUGHT YOU DIDN'T NEED AN EXPERT...DAMAGES!

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Supporting a claim with competent expert testimony is essential to recovery. The right expert can turn a good claim into a recoverable claim. While many people are quick to secure causation experts, they may neglect to consider the need for expert testimony on the issue of damages. Building a recoverable claim means choosing the right expert for both causation and damages. In order to select the right expert to evaluate your claim, it is necessary to first have a comprehensive understanding of the different types of damages and how they are measured.

### Types Of Damages – Direct Or Consequential

Damages primarily fall into two categories: direct damages and consequential damages. Direct damages generally include damage to real property, personal property (e.g., furniture, computers and clothing), inventory and equipment. They are also generally tangible and can be easily quantified after a loss. Consequential damages, on the other hand, encompass items such as emergency clean-up expenses (e.g., water extraction,

board up), loss of business income and other similar expenses. Unlike direct damages, consequential damages are often intangible and more difficult to quantify. Most large loss claims will involve both direct and consequential damages. Therefore, it is important to know how to quantify and prove these damages.

### How To Quantify Direct Damages

The three methods by which direct damages are most often measured are Replacement Cost Value, Actual Cash Value and Fair Market Value. Replacement Cost Value (RCV) represents the cost to repair or replace damaged property. Actual Cash Value (ACV) is the cost to repair or replace damaged property, less a reduction for depreciation. Fair Market Value (FMV) is an estimate of what a willing buyer would pay to a willing seller in a free market for certain property. Insurance representatives often focus on RCV and ACV because these valuation methods are insurance terms describing policies written on one basis or the other. Courts, however, generally rely upon the substantive >>

law of the jurisdiction. In the context of a tort action based upon negligence, the measure of damages is the diminution in the FMV of property. Diminution in FMV is quantified by taking the difference between the FMV of property immediately before and after a loss. Often, the quantification of damages based upon FMV can be substantially different from a calculation of damages based upon ACV or RCV. The distinction between what is paid under an insurance policy and what is recoverable in court can be confusing and lead to problems in identifying appropriate damages witnesses.

#### **Who Can Testify As To The Value Of Damaged Property?**

Different measures of direct damages require testimony from various persons. There are some instances where very specialized experts are needed or where no expert is needed at all. Looking first to claims for damage to real property, someone familiar with the repair of damaged buildings can likely be qualified to provide expert testimony about the cost of repairs since this primarily requires only thorough knowledge of the costs of building materials, labor and equipment. However, this will do little good at the time of trial if the law requires that damages be measured as the diminution in FMV. In order to present evidence on diminution in FMV, a real estate appraiser will likely be needed. On the other hand, some jurisdictions such as Pennsylvania, do not require an expert opinion as to FMV. Courts in Pennsylvania accept the "owner opinion rule" and permit property owners to offer an opinion as to the FMV of their property. The rule is based upon the premise that the owner of property is familiar with the cost of the property, the age of the property and the market value of the property. It is important to consult with subrogation counsel early on in order to determine what measure of damages the courts in your jurisdiction follow and what experts, if any, will be needed to offer an opinion on damages at the time of trial.

While owners of real and personal property can sometimes testify as to its value, expert testimony is almost always needed for inventory claims. Generally, this is because inventory claims involve far more items than people can mentally keep track of and inventory tends to turn over relatively quickly compared to real property or the contents of one's home. This is compounded by the fact that many businesses do not electronically track their inventory in real time. Without real time data as to what items were in inventory at the time of loss, a forensic accountant will have to be retained. Forensic accountants specialize in calculating and quantifying losses and economic damage utilizing an understanding of business information, financial reporting systems, accounting, and litigation procedures. A forensic accountant will evaluate past invoices, receipts, purchase data, income tax records and sales data. After reconstructing the value of the lost or damaged inventory, the forensic accountant can then offer an opinion as to the value of the inventory on hand at the time of loss. It is important to remember that the forensic accountant must be qualified as an expert to offer such opinion testimony. He or she should be able to testify that the system used in evaluating the inventory is based upon generally accepted accounting principles and is commonly used in the accounting field outside of the courtroom. Also remember that the amount paid under the claim for damaged inventory may be much greater than the recoverable amount. Some policies will allow for payment of the selling price of damaged goods when the law

only allows for the recovery of the cost of the goods to the seller. Unless the insured lost sales as the result of the loss of inventory, the recoverable amount is the cost of replacement inventory, not the selling price of the inventory. Often, a claim which results in lost inventory will also result in damage to equipment within the building.

Equipment claims also illustrate the need for specialized expertise. Equipment can encompass anything from refrigerated display cases to plastic molding machines to forklifts. Expensive and sometimes unique industrial equipment, such as a large metal press, cannot be priced by simple internet research alone. The value of such equipment is affected by market factors other than age and condition alone. These factors include the geographical location of the equipment, the current supply and demand and the style of the equipment. For example, older equipment will likely be obsolete or outdated and thus less valuable on the open market. Experts with specific knowledge of the type of equipment and the market for that equipment, such as used equipment brokers and dealers, must be called upon to provide testimony in these areas. These experts should have experience buying and selling the type of equipment at issue and should be familiar with current market conditions.

#### **How To Evaluate Consequential Damages**

As noted above, consequential damages are physically intangible and thus harder to evaluate. One of the most common items of consequential damages is loss of business income. Business income losses arise when an insured's business is unable to operate or is limited in its ability to operate after a loss. Most businesses will suffer a loss of business income after a fire or flood, whether it is a retail store that must close for cleanup or a factory that has to stop production to replace water damaged equipment. Evaluating a claim for loss of business income requires looking at the past performance of the business and determining if there has been an unanticipated decrease in performance since the loss. Be mindful that all businesses have trends. A pool supply store will have greater sales in spring and summer, while a car dealer may do better after tax time. These trends will be the same regardless of a loss and must be taken into account. For example, the pool supply store experienced a loss at the end of the summer. As a result of the loss, portions of the store were unusable for two weeks and certain inventory could not be sold. During those two weeks sales dropped dramatically. While some of that drop may have been due to the loss, most of it may simply be due to the fact that it was the end of the summer season. Understanding and calculating such trends cannot be done without the expertise of an accountant or actuary.

#### **Who Can Testify As To Consequential Damages Such As Loss Of Business Income?**

Much like an inventory claim where there is no electronic data available, a claim for loss of business income will require the reconstruction and evaluation of past financial data. A forensic accountant or an actuary will need to investigate past sales data, sales trends, market factors and inventory and then calculate the loss of income. It is important that the forensic accountant be familiar with the market trends of the business being evaluated, be able to identify his or her sources of data and be able to testify that the methods used were based upon >>

accepted accounting or actuarial principles. While the accountant or actuary will rely upon information from the insureds, the insureds themselves are not qualified in most jurisdictions to offer an opinion as to their loss of income. Certain states, however, such as Texas and Idaho, will allow the owner of a business to testify concerning lost profits, with the accuracy of this testimony going to the weight of the opinion and not its admissibility. In certain states, just as with claims for real property, the owner of a business is presumed to be familiar with its value. As noted earlier, consulting with subrogation counsel early on will help you determine the law in your jurisdiction and what type of expert, if any, is necessary to present your claim.

#### **Proving Cases That Involve Direct And Consequential Damages**

Many claims are comprised of both direct and consequential damages and will require opinions from multiple experts. In a recent case handled by the authors, a barn collapse killed and injured a stock of dairy cows. Expertise from local cattle auctioneers was required to establish the value of the deceased cattle (direct damages, business personal property). As for the injured animals, some had stopped producing milk while others were producing much less than before the loss. A dairy production expert had to be consulted to explain the loss in production and how it was related to the trauma from the collapse (consequential damages, loss of business income). A forensic accountant then pulled all of these figures together. As you can see, claims for loss of business income are, unfortunately, one of the most subjective categories of consequential damages. Experts will need to be well-versed in

their field to justify their conclusions on claims such as these. They must be able to clearly explain their methodology and the sources of data they relied upon. The cattle auctioneer noted above had to be able to show sales figures for similar cattle and offer some background on the local cattle market. It was also necessary for the dairy production expert in the above case to ascertain the weight and age of each cow, the average milk production to date, the health history of the cows and the facts of the loss and its aftermath. The forensic accountant illustrated how these numbers combine to equal a total damages figure. Without these experts working together, it would be impossible to get an accurate picture of the overall damages incurred by the insured.

Putting on your best case is not just about having the right evidence; it is about having the right experts to evaluate and present that evidence to the jury. As noted in the above examples, specialized knowledge is necessary to calculate the extent of damage for most inventory, equipment and business interruption claims. Selecting an expert who is familiar with the measure of damages and the type of property itself (e.g., store fixtures, industrial metal presses, cattle) is essential to presenting credible damages testimony. This will often result in the need for opinions from multiple experts with diverse expertise. By working with subrogation counsel early to discuss the law of damages in your jurisdiction, including the measure of damages, who may offer testimony, and what expert or combination of experts are best suited to testify on these issues, you can ensure that your next case is a recoverable case.

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