

Newer Isn't Necessarily Better

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The complexity of a damages assessment is heightened in instances involving the total destruction of commercial real property. Most often, these instances include buildings or factories that have been destroyed in fires or by explosions. Business owners are generally left with no option but to rebuild, and if liability is established against a defendant, then adjusters, legal counsel and the court are faced with the difficult task of determining whether damages should be measured by the cost of replacing the building or the diminution in the building's value.

The law suggests that in most cases, the "starting point" in measuring damages is the property's replacement cost. Indeed, in the majority of court cases involving the near total destruction of commercial property, the court assessed damages on that basis. This approach was adopted because it was reasonable for the insured to rebuild its premises and resume its commercial operations.

Once it is accepted that replacement cost is the appropriate measure of damages, counsel for the defendant will often argue that damages should be reduced to account for betterment, enhancement or improvement. This reduction is premised on the general rationale of damages: they serve to put the plaintiff in the *same position* he or she would have been in but for the wrong that he or she is receiving compensation for. The plaintiff is not entitled to be placed in a better position; only the same position.

Practically speaking, it is usually impossible to replace a building without putting it into a better condition than it was before the damage was sustained. Indeed, in several court cases, it was impossible to rebuild an identical structure due to changes in planning laws and buildings codes. Therefore, unless the replacement cost is reduced for betterment, the plaintiff will likely be overcompensated. The issue of betterment is aptly described by Professor Waddams in *The Law of Damages* (1983) where he states:

It commonly occurs that a plaintiff, in making good damage to property, will not be able to restore himself to his pre-loss position without improving it. If the plaintiff's ten-year-old roof is damaged, he will not be able to purchase a replacement ten-year-old roof. The only reasonable course will be to replace with a new roof. If roofs have a life of twenty years, and the defendant is compelled to pay the full cost of the replacement, the plaintiff will be in a better position after satisfaction of the judgment than if the damage had not occurred in the first place. It would seem, therefore, that the damages should be reduced by the value of the improvement of the plaintiff's position. The contrary argument is that it is the defendant's wrong that has caused the need for replacement, and that the plaintiff should not be compelled against his will to invest his money in a replacement he might not have chosen to make. These arguments, however, do not appear to be conclusive. The fact that the defendant is a wrongdoer is not sufficient reason for over-compensation. The argument that the plaintiff is forced to make an unwanted investment can be met by conceding the point and increasing the damages by any loss suffered by the plaintiff's making such an investment. The plaintiff's interest can be met by putting the onus of proof on the defendant to show that the plaintiff does not suffer any loss by this reason.

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...The increase in the plaintiff's wealth is one that could not have occurred in the absence of the wrong. It is suggested, therefore, that an anticipated benefit accruing to the plaintiff on repairing damaged property ought to be taken into account to reduce damages, with compensation, however, for the cost to the plaintiff of the unexpected expenditure required of him, and with the onus of proof upon the defendant in case of doubt on this question, or on the value of the benefit.

As discussed by Professor Waddams, the rationale for not reducing damages for betterment is the idea that because the defendant damaged the plaintiff's property, the plaintiff was forced to invest money prematurely in the replacement of property. The law suggests that in at least some instances, this concern can be addressed by compensating the plaintiff for this "forced investment" but still reducing the damages award for betterment. The law is adamant that whether a reduction is warranted must be established on a case-by-case basis. On several occasions, the court has recognized that the mere substitution of new for old may not involve any increase in the value of the property as a whole. Further, the law imposes an onus on the defendant to prove that a betterment exists, and that this betterment warrants a reduction in the replacement cost.

The law acknowledges that there may be instances in which the replacement cost should be reduced for betterment; however, there are relatively few instances in which a reduction has actually been awarded, and the cases show that it will only be done if the defendant provides the court with an ample evidentiary basis. Indeed, the court refused to reduce the damages award in the two leading court cases on betterment, *James Street Hardware & Furniture Co. & Spizziri* (1987), 62 O.R. (2d) 385 (Ont. C.A.) and *Nan v. Black Pine Manufacturing Ltd.* (1991), 80 D.L.R. (4th) 153 (B.C.C.A.). In both cases, the court refused to reduce the damages award because amongst other things, the defendants failed to prove that there had been any betterment.

In *James Street*, a building was destroyed by a fire attributed to negligent welding on the part of a subcontractor. Changes in the building code prevented the plaintiff from reconstructing the original building, and instead, a larger building was constructed. The defendant argued that the cost of replacement should be reduced to reflect the betterment; however, the court held that the defendant failed to provide the requisite evidentiary basis. In particular, the court commented that "there was no satisfactory evidence on the life expectancy of the building, either before the fire or what it would have been after being repaired – nor was there any evidence as to the amount of the increase in value, if any, after the fire".

Another court case worth discussing is *Lamont Health Care Centre v. Delnor Construction Ltd.*, 2003 ABQB 998. In *Lamont*, two wings of a hospital were virtually destroyed by a fire attributed to the propane torch of a roofing subcontractor. Instead of rebuilding the two hospital wings, the plaintiff constructed a new larger facility. The plaintiff claimed that the replacement cost was the appropriate measure of damage, and if accepted, this amount should be reduced due to betterment. The hospital wings were 48 and 28 years old and it was always the hospital's intention to demolish and build a new facility; it was only a matter of time and government funding. In this instance, the court reviewed the damages principles in *Nan v. Black Pine Manufacturing Ltd.*, but held that it wasn't reasonable for the defendants to pay the cost of replacement. Because the hospital wings would inevitably have been demolished and replaced, damages were calculated by determining the net financing cost for the replacement building. In other words, the plaintiff was only compensated for "its loss of use of the money used to rebuild between the time it expended the money and the time it otherwise would have expended it for the construction of the new facility".

In summary, when faced with the destruction of commercial real property, adjusters and lawyers should both be aware that the starting point in a damages assessment is usually the

replacement value of the property. Thereafter, it is open to the defendant to assert that as a result of the new building, the plaintiff has obtained a betterment, and that a corresponding deduction is warranted. A deduction for betterment is not automatic; rather, the law imposes a burden of proof on the defendant, who must establish that a betterment exists, and moreover, that the betterment warrants a reduction in damages. Defendants should be forewarned that in advancing this argument, the plaintiff will likely argue that newer isn't necessarily better, and in the alternative, the defendant's wrong forced the plaintiff to invest its monies in a premature expenditure.