RECOVERY OF DIMINISHED VALUE IN FIRST PARTY PROPERTY INSURANCE CLAIMS

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I. DEFINING DIMINISHED VALUE

When property is damaged, a policyholder generally expects to be “made whole” by its first-party property insurer. With respect to the physical loss or damage, frequently, repair or replacement of the damaged property is sufficient to return the policyholder’s property to its “pre-loss” condition. But sometimes it is not enough. There are times when property is fully repaired or replaced but is perceived as less valuable. For example, if you are buying a used car and you see two identical cars on the car lot, one damaged but properly repaired and one never damaged, which one would you prefer? The reality is that whether or not the damage has affected the appearance or function of the vehicle, people choose the never damaged vehicle. This perceived difference is what is known as “stigma damage” or diminished value and may

¹ This paper is presented at the American Bar Association’s Insurance Coverage Litigation Committee Seminar held in Tucson, AZ, Feb. 27-Mar. 2, 2013. This paper is a general discussion of the issues addressed herein from both policyholder and insurer perspectives. The views and commentary herein do not necessarily reflect those of the authors, their firms, or their clients in any given matter.
drive down the price of the car. Likewise, a building damaged by an earthquake and fully repaired and reopened may still have a residual diminished market value because of the incident. When is this kind of measurable diminished value loss covered?

In the context of diminished value claims, it is important to distinguish between first-party claims and third-party claims. A first-party claim is a claim a policyholder makes against its own policy. Because the policy is a contract between the policyholder and its insurer, the diminished value claim is governed by contract law. Thus, the policy itself may have a very clear answer. A third-party claim, however, arises when someone other than the policyholder makes a claim against the policyholder. For example, if the policyholder is at fault in an automobile accident with a third party, that party can make a claim against the policyholder and claim diminution in value as a tort damage. Or negligent construction activity at a property can damage an adjacent property, the owner of which might claim diminution in value as a consequential damage in tort. Thus, the outcome in the third-party context is governed by tort law. Third-party cases can be instructive in the first-party context, but in a first-party claim, the starting point will always be the contract language.

Below we address the issue first in the context of auto claims, then commercial property claims.

II. RECOVERY OF POST-REPAIR DIMINUTION IN VALUE IN AUTO CLAIMS

There is a split of authority among the various states as to whether diminished value is recoverable with respect to claims for automobile repair

A. Majority View

The seminal case on diminished value auto claims in Florida is the Supreme Court of Florida’s decision in *Siegle v. Progressive Consumers Insurance Co.*, 819 So. 2d 732 (Fla.
The facts of *Siegle* are straightforward. Ms. Siegle was insured by Progressive for auto damage for “loss to your insured auto or its equipment caused by...a collision.” “Loss” was defined as “direct and accidental loss of or damage to your insured auto.” The applicable limit of liability provision allowed the insured to recover “the amount necessary to repair or replace the property with other of the like kind and quality.” Progressive exercised its option to repair the vehicle. The policyholder then filed suit for breach of contract, seeking the “difference between the pre-loss value of the insured automobile and its value after it was repaired and returned.”

On appeal, Florida’s Fourth District Court of Appeal affirmed the trial court’s dismissal of the policyholders complaint, relying on the policy language based rationale of *Carlton v. Trinity Universal Insurance Co.*, 32 S.W. 3d 454 (Tex. App. 2000), stating that:

“...where an insurer has fully, completely, and adequately repaired or replaced the property with other of like kind and quality, any reduction in market value of the vehicle due to factors that are not subject to repair or replacement cannot be deemed a component of the cost of repair or replacement...Additionally, in the instant case, we find that the language of the policy simply does not obligate Progressive to both complete a quality, first rate repair of the vehicle and pay money to the insured...These methods for compensation for the loss are set forth in the alternative.”

At the Supreme Court level, the policyholder made two principal arguments. Siegle asserted that the terms “repair,” “replace,” and “like kind or quality” were ambiguous, and therefore the term “loss” should be construed in her favor to include diminished value, principally because courts from other jurisdictions reached different conclusions as to the meaning of these words. Even if the terms were not ambiguous, Siegle argued that the policy should be interpreted to cover diminished value. The Court rejected these arguments:

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Clearly, the intent of the drafter of these provisions was to provide the insurer with two options upon the occurrence of a “loss.” The insurer could reimburse the insured through money payment, or it could pay to repair or replace the automobile. If, as here, the repair option was chosen, the insurer’s liability was limited to the monetary amount necessary to repair the car’s function and appearance, commensurate with the condition of the auto prior to the loss.

Proper interpretation of the policy language at hand requires that we deem diminished value a loss not covered by this policy. Acceptance of the [insured’s] position that the proper definition of “repair” includes compensation for lost value would negate the insurer’s choice of remedy explicitly contained in the contractual text…If we accepted the petitioner’s arguments, even where the insurer chose to repair an insured vehicle, thereby limiting its liability to the cost of repair or replacement, it would be bound to also pay a portion of the car’s cash value – a “strained, forced [and] unrealistic construction…”

*Siegle*, 819 So. 2d at 739.

Other states, including Texas, have followed suit. In *American Manufacturers Mutual Insurance Company v. Schaefer*, 124 S.W.3d 154 (Tex. 2003), the Texas Supreme Court resolved a split in the Texas intermediate appellate courts as to whether standard auto insurance policies covered first-party claims for diminished value. Schaefer, the policyholder, had filed a class action lawsuit against American Manufacturers and several other insurers for failing to compensate him for the diminished value of his repaired car, an amount he claimed to be $2,600. 124 S.W.3d at 156. On cross-motions for summary judgment, the trial court had granted American Manufacturers’ motion and denied Schaefer’s. An intermediate court reversed the trial court judgment, and American Manufacturers appealed. *Id.* at 156 – 57.

The Texas Supreme Court held that the policy language was unambiguous, and that American Manufacturers’ obligation to Schaefer was limited to that described in the “Limit of Liability” section. That section stated that American Manufacturers’ liability for loss was limited to the damaged vehicle’s “actual cash value” or the amount needed “to repair or replace”
the vehicle, whichever is less. Id. at 158. The Court noted that it did not believe the ordinary or generally accepted meaning of the word “repair” included compensating the policyholder for “the market’s perception that a damaged but fully and adequately repaired vehicle has an intrinsic value less than that of a never-damaged car.” Id. at 159. The Court added that the words “repair” and “replace,” as used in the context of a vehicle, “connote something tangible, like removing dents, fixing parts, or replacing the vehicle with a comparable substitute.” Id. at 160.

The Court also rejected Schaefer’s argument that diminished value was covered because it was not expressly excluded from coverage by the policy, explaining that an exclusion’s purpose is to remove from coverage an item that would otherwise have been included. As diminished value was never included in coverage, the absence of an exclusion was immaterial. Id. The Court also distinguished and/or abrogated older Texas appellate court decisions that appeared to permit recovery for diminished value, explaining that some of the cases involved claims that the repairs undertaken by the insurer were inadequate or replacements where the insurer had not satisfied the “like kind or quality” language. Id. at 161 – 62. As Schaefer had not alleged that the repairs undertaken by the insurer were faulty, incomplete or inadequate, Schaefer did not have a claim under those cases. Other cases had erroneously used a tort measure of damages that was appropriate for determining the value of the loss for liability coverage but was not appropriate for first-party collision coverage. Id.

B. Minority View

Georgia is one of the few states that requires insurers to compensate auto-owners for post-repair diminished value. Since 1926, Georgia law has recognized that an insurer’s obligation to pay for actual loss or damage to insured property is measured as the difference in
value of property immediately before and after injury. In *U.S. Fidelity & Guar. Co. v. Corbett*, 35 Ga. App. 606 (1926), the Georgia Court of Appeals stated:

the undertaking of the company to insure the owner against “actual loss or damage” must be taken as the primary obligation, under which the measure of the liability would be the difference between the value of the property immediately before the injury and its value immediately afterwards; and the stipulation that the liability should not exceed the cost of repair or replacement must be construed as a subordinate provision, limiting or abating the primary liability, to be pleaded defensively if the insurer would diminish or limit the amount of recovery by reason thereof.

Nevertheless, the common claims handling practices of the 1970s, 1980s, and 1990s, involved payment of the cost of repair and the presumption that such repairs, properly performed, returned the vehicle to its pre-loss value. Exceptions may have been made for antique vehicles, high-end specialty vehicles, and other unusual situations, but the typical approach was to refuse to recognize diminished value except in extraordinary circumstances.

That practice was rooted in the policy language contained in the Limits of Liability Clause that attempts to limit any recovery to actual cash value (ACV). The typical policy provides:

Limits of Liability

The limit of our liability for any loss:

(1) is the actual cash value of the property at the time of the loss;

(2) and will not exceed the cost to repair or replace the property, or any of its parts, with others of like kind and quality.

Most policyholders and attorneys operated under this assumption for decades. When dealing with the policyholder’s collision or comprehensive claim, many insurers paid only the cost of repair, taking the position that any incidental costs such as loss of use required a separate rental car reimbursement coverage, and any depreciation was simply not covered. Although the
law talked about value, claims practices focused on the more easily quantifiable cost of repair. The question remained whether the difference in a car’s value before and after an accident also included the difference in the car’s reputational value before and after injury.

In 2001, the Georgia Supreme Court answered yes to this question, insofar as it applied to automobiles. In *State Farm Mut. Auto Ins. Co. v. Mabry*, 274 Ga. 498 (2001), the Georgia Supreme Court ruled that an insurer’s obligation to repair a damaged auto includes payment for any diminution in value the car sustained. The court noted that there is a general perception among car buyers, as between two substantially similar cars, one that has been wrecked and repaired is worth less than one that has never been wrecked. It is this difference in perceived value that must be considered in handling a claim for property damage because “what is lost when physical damage occurs is both utility and value, therefore, the insurer’s obligation to pay for the loss includes payments for any lost value.”

The *Mabry* Court further explained:

(value, not condition, is the baseline for the measure of damages in a claim under an automobile insurance policy in which the insurer undertakes to pay for the insured's loss from a covered event, and that a limitation of liability provision affording the insurer an option to repair serves only to abate, not eliminate, the insurer's liability for the difference between pre-loss value and post-loss value.

*Id.* Thus, even though a policy may have a replace or repair provision limiting its liability to either measure of damages, this limitation of liability clause does not eliminate an insurer’s duty to pay for diminution in value.

Other jurisdictions are in accord. In D.C., for example, the Court agreed in *American Service Center Associates v. Helton*, 867 A.2d 235 (D.C. 2005). In a case involving an automobile collision, the Court applied the more “basic rule” that the “measure of damages for partial destruction or injury to a chattel is the difference in value of the chattel immediately
before and after the injury.” *Id.* at 240. Thus, the Court held that “recovery may be had for both the reasonable cost of repair and the residual diminution in value after repair, provided that the award does not exceed the gross diminution in value.” *Id.* at 243.

The D.C. Court of Appeals perceived its ruling to be “overwhelmingly supported by decisions in other jurisdictions that have considered the issue – including neighboring Maryland and Virginia – which allow for recovery of the cost of repair made plus the residual diminution in value. A long pedigree of influential commentary also supports this position.” *Id.* at 243-44 & notes 11 & 12 (citing cases from Colorado, Iowa, Kansas, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Virginia, and West Virginia; and from the Restatement of Torts).

The result in any given case will, of course, depend on policy language and the governing state law. In a state with unsettled law, both sides will have meritorious arguments based upon well-explained case law form other states.

C. **Calculation of Diminished Value**

After the Georgia Supreme Court ruled that diminished value was an element of recovery for property damage claims, the question then became how to calculate diminished value. In a stroke of negotiating brilliance, a compromise was reached. As a class action, *Mabry* would have required thousands of individual damage trials to determine each class member’s actual diminished value. Neither the plaintiffs’ attorneys nor the court could afford to try thousands of cases, most of which would result in less than $500 in damages. The insurance industry wanted predictability. Diminished value that was subject to expert testimony by opposing parties would
be unpredictable, but a formula would be predictable. State Farm sampled thousands of claims from the class to determine the best of many formulas available at that time\(^3\).

The 17(c) formula, based upon a previous regulation issued by the Georgia Insurance Commissioner’s office and used by Safeco, Progressive, Nationwide and Crawford & Co., resulted in the lowest calculation and was the easiest to calculate. Under the 17(c) formula, a car’s Base Loss in Value (10% of the NADA retail value) is multiplied by mileage and damage modifiers (on a scale of 0-1) based on the number of miles the car has and the extent of the damage it sustained. So, for example, if a car valued at $16,000 with 50,000 miles sustained moderate damage, its diminished value would be calculated as: $1600 \times .50 \text{ (moderate damage modifier)} \times .60 \text{ (mileage modifier)}$ for a diminished value of $480.

However, there was a debate surrounding the 17(c) formula because many consumers contended it arbitrarily assigned different modifiers based on mileage and damage. Also, opponents argued that a car’s NADA value already took mileage into consideration, so the mileage modifier was a double penalty. Third, detractors argued that the damage modifier should be based on the cost to repair, not some arbitrary scale of 0-1. Many people also contended that a car must be physically inspected in order to determine its post-accident value, and the 17(c) formula is not based on a physical inspection. Despite its flaws, the 17(c) formula offers an easy and uniform way of assessing diminished value and is still used by most insurers in Georgia today.

Like Georgia, North Carolina also holds that post-repair diminished value is recoverable under an auto policy.\(^4\) Unlike Georgia, however, North Carolina has taken it one step further and

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\(^3\) Those formulas included the ClaimCoach.com system, the Classic Car Appraisal Service (Don Peterson) methodology, and the 17(c) formula distributed by the Georgia Insurance Commissioner’s office and used by Safeco, Progressive, Nationwide and Crawford & Co.
passed legislation which outlines the procedure for a policyholder to make a claim against his/her insurer for diminished value. N.C. Gen. Stat. Ann. § 20-279.21(d)(1) provides that, if an insurer’s and policyholder’s estimate of diminished value differs by more than $2,000 or 25% of the vehicle’s fair market retail value, then each party selects an independent appraiser to appraise the loss. If they cannot agreed on a number, then a third party umpire is called to determine the diminished value, whose report is binding on the parties. Though time-consuming, this method avoids the criticism of the 17(c) formula and keeps the parties out of court.

III. RECOVERY OF POST-REPAIR DIMINUTION IN VALUE FOR REAL PROPERTY CLAIMS

For 20 years the concept of diminished value in the home and commercial building market remained quietly behind the scenes. Automobiles are fungible chattel. As an assembly line manufactured product, one brand new Ford Fusion is the same as every other comparably equipped new Ford Fusion. In comparison, each home and each commercial building is unique if for no other reason than their locations vary. How does one home or building compare to another even if their floor plans are identical?

Not only is it geographically unique, but real estate is constructed manually rather than on an assembly line. Even two side-by-side, otherwise identical, tract homes are different because of the artisan nature of building construction. How could diminished value be determined for a home or building?

Not surprisingly, different states have different answers.

A. The Latest: Royal Capital v. Maryland Casualty (Ga. 2012)

1. Background

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4 Parker v. Hensley, 625 S.E.2d 182 (N.C. App. 2006) (affirming damage award for diminution in value after car repaired)
**Royal Capital v. Maryland Casualty Co.**, 291 Ga. 262 (2012) was the first time a Georgia state court addressed expressly whether diminished value can be recovered in the commercial property context.

Prior to **Royal Capital**, only a handful of Georgia courts had touched on the issue. In **Nuco Investments v. Hartford Fire Ins.**, 2005 WL 3307089 (N.D. Ga. 2005), the United States District Court for the Northern District of Georgia found that diminution in value was an element of replacement cost arising out of mold damage to a motel. The court rejected the insurer’s argument that diminution in value was a consequential damage not covered by the policy’s insuring agreement to pay for direct loss or damage to the insured property. However, **Nuco** was an unpublished decision by a federal court making an *Erie* guess as to what Georgia law was on this issue. As such, no one viewed it as controlling on the issue of diminution in value.

The first state court case in Georgia to touch on the issue of diminished value for real property loss was **City of Atlanta v. Broadnax**, 285 Ga. App. 430 (2007). In **Broadnax**, homeowners brought nuisance claims against the City of Atlanta for damage to their property caused by recurrent flooding of city sewer water. The homeowners sought to recover both damages for costs to repair their property plus the diminished value of their homes. The court of appeals ruled that the homeowners could not recover damage for both diminution in value and cost to repair because such constituted an impermissible double recovery.

As recently as 2012, the Eleventh Circuit held that diminished value was not “property damage” that was covered by a commercial general liability policy. **Scottsdale Ins. Co. v. Pursley**, 450 Fed. Appx. 888 (11th Cir. 2012). Thus, in leading up to the Supreme Court’s ruling in **Royal Capital**, the issue was not well-settled.

2. **Facts and Procedural Posture**
In May 2012, the Georgia Supreme Court faced the question of whether the rule announced in *Mabry* – that diminution in value is recoverable as a part of loss of or damage to insured property – applied to real property policies. This case arose out of property damage to a commercial building known as The Capital Building located in the Buckhead business district in Atlanta, Georgia. The Capital Building is owned by Royal Capital Development, LLC. In January and February, 2008, construction on adjacent property caused physical damage to the Capital Building.

At the time, the building was insured with Maryland Casualty. The policy’s coverage grant states “We will pay for direct physical loss of or damage to Covered Property.” The “Loss Payment” section of the policy further provides that:

E. Loss Payment

1. In the event of loss or damage covered by this Coverage Part, at our option we will either:

   (a) pay the value of lost or damaged property;
   (b) pay the cost of repairing or replacing the lost or damaged property;
   (c) take all or any part of the property at an agreed or appraised value; or
   (d) repair, rebuild, or replace the property with other property of comparable kind and quality.

Royal Capital submitted its first-party claim to Maryland Casualty in 2008. The insurer acknowledged that the physical damage to the building was a covered loss and paid Royal Capital $1,132,072.96 to repair the building pursuant to payment option (b). Royal Capital also submitted appraisals to Maryland Casualty which concluded the building had suffered “stigma damage” or diminution in value due to the physical damage it sustained. Maryland Casualty denied coverage for the alleged diminution in value on grounds that it was not covered under the payment option selected. Thereafter, Royal Capital filed suit for breach of contract.
The U.S. District Court for the Northern District of Georgia concluded that damages for diminution in value were not covered because the plain language of the loss payment option selected by Maryland Casualty, the cost of repair or replacement, clearly did not encompass damages for lost value. Royal Capital appealed this ruling to the 11th Circuit, who certified the following question to the Georgia Supreme Court:

For an insurance contract providing coverage for “direct physical loss of or damage to” a building that allows the insurer the option of paying either “the cost of repairing the building” or “the loss of value,” if the insurer elects to repair the building, must it also compensate the insured for the diminution in value of the property resulting from stigma due to its having been physically damaged?

The Georgia Supreme Court considered the issue of diminished value claims for real property.

3. Insurer Arguments

Maryland Casualty and its supporting amici advanced five primary arguments against extending real property coverage to cover diminished value. First, the insurers argued that the language of the Maryland Casualty policy did not support recovery of diminished value. The policy’s coverage grant promises to pay for “direct physical loss of or damage to” covered property. The insurers argued that diminution in value does not constitute either “direct” or “physical” damage. Specifically, they argued that stigma damage cannot be accurately characterized as “direct” damage because any damage from a building’s diminution in market value will not be realized unless and until it is sold. As a result, it is consequential damage, not direct damage. They also argued that diminished value is an intangible concept and therefore does not constitute “physical” damage.

Second, the insurers argued that the coverage grant was purposefully crafted to cover only “direct physical” damage so as to preclude coverage for diminution in value. Under contract interpretation rules, a policy’s exclusions and limitations are strictly construed against

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the insurer. How best then to ensure a policy does not provide coverage for diminution in value? Never give it in the first place. Against the backdrop of Mabry, where the policy provided broad coverage for all “loss,” policies such as the one in Royal Capital have been carefully worded to narrow coverage only to “direct physical” loss or damage.

Third, the insurers’ arguments before the Supreme Court also focused on the disjunctive nature of the coverage grant. As argued by the insurers, the policy provides coverage for “physical loss of or damage to” covered property (emphasis added). It does not provide coverage for diminution in value (loss) and repair costs (damage). Indeed, other jurisdictions have found that coverage for property damage does not include diminution in value in addition to repair costs. The Supreme Court of Minnesota – a state where the law mandates “diminution in value” coverage under auto policies like Georgia – has found no coverage for diminished value in a claim involving real property where the policy provided coverage for both tangible and intangible injuries. Federated Mut. Ins. Co. v. Concrete Units, Inc., 363 N.W.2d 751, 756 (Minn. 1985) Thus, to find that the policy provides coverage for diminution in value in addition to repair costs would effectively convert the coverage grant’s “or” to “and.”

Maryland Casualty also pointed to the fact that the “Loss Payment” provision of the policy was constructed in the alternative to reflect the choice between payment for loss or damage. The policy provides, in pertinent part, that, the insurer will pay either (a) the value of lost or damaged property or (b) the cost of repairing or replacing the lost or damaged property. Maryland Casualty did not dispute that diminished value would be covered under loss payment (a) for lost value. However, option (b) was chosen, and, as the District Court found, the cost to repair or replace the building does not encompass damage for diminished value.

Fourth, Maryland Casualty urged that Mabry was inapplicable to this type of commercial
property damage because it involved a different type of policy. The Insurers argued the policy in *Mabry* was strictly construed against the insurer and in favor of coverage because it was a consumer automobile policy, which often takes the form of an adhesion contract purchased off the shelf by unsophisticated motorists. In contrast, commercial property policies are negotiated at arms’ length by knowledgeable business entities, often with the aid of expert insurance brokers. As such, these business entities have no reason to expect that diminution in value would be covered by a commercial property policy, in contrast to an unknowing consumer public that may assume such.

Fifth, the insurers counseled against extending *Mabry* to real property policies because of the significant differences between cars and buildings. The stigma damage theory is premised on the assumption that a purchaser, when faced with two otherwise identical cars, will choose the unwrecked car over one that has been damaged and repaired (or will choose the repaired car at a discounted price). This theory is based on the fact that cars are identical, fungible goods. Indeed, cars are often mass-produced by the same manufacturer using the same model and materials. As such, when a car is damaged, it is often perceived to be worth less because the original factory parts might not be used in the repair.

In contrast, buildings are custom-built and are rarely identical in terms of life span, age, materials, and design. The value of a house does not depend on its being mass produced with like parts and labor, as with cars. Rather, a building’s value depends on several factors, such as location, size, and functionality. Its value may diminish for numerous reasons, such as economic downturn, decreasing population, consumer traffic patterns, property tax assessments, and changes in neighborhood reputation. Stigma damage – measured as the loss in market value – can be attributed to a number of factors unrelated to damage repairs. Thus, one danger in
extending commercial property coverage to diminution in value was that market downturns are likely to encourage policyholders to file meritless stigma claims in hopes of recovering lost market value under the guise of a property damage claim.

4. Policyholder Arguments

The policyholder in Royal Capital advanced three principal lines of argument in favor of extending coverage to diminished value. First, the rule articulated in Mabry – that coverage for physical damage to property includes any lost value of the property, including any diminution in value after repair – is consistent with the longstanding rule that the measure of a property insurer’s liability to the policyholder for loss or damage to covered property is the difference between the value of the property immediately before the injury and its value immediately afterwards. The policy purchased by Royal Capital – just as the policy at issue in Mabry – gave the insurer the option to settle a loss by paying either the actual cash value of the damaged property or the cost of repair or replacement. In such a situation, the Mabry court looked at the purpose behind this loss settlement scheme chosen by the insurer, that is, to make the policyholder whole. This requires damages to be measured based upon value to the policyholder, not simply utility. Making the policyholder whole requires that it be compensated for the lost value of the property caused by a covered peril. Such lost value must include any lost value to the property after the damage is repaired.

Second, as a matter of pure policy interpretation, the Maryland Casualty policy covers “direct physical loss of or damage to” the policyholder’s property, unless diminution in value is otherwise expressly excluded. The policyholder argued that if the insurer wanted to exclude damages measured by post-repair diminution, it must clearly and expressly communicate that intent through exclusionary policy language. Because Maryland Casualty failed to do so here,
the policyholder was entitled to the full measure of the property’s lost value, including diminution flowing from and following repair.

Third, Royal Capital also argued that the type of insured property is immaterial, and there was no basis to treat automobiles any differently from real property for the purposes of the analysis. In so doing, they challenged the insurer’s argument – that buildings are not as likely to suffer post-repair loss in value – as unsupported by the record and a factual dispute ripe for a jury considering the circumstances of a particular case. Insurer arguments focused on the sophistication of the policyholder and the alleged higher premiums that Royal Capital should have paid for such coverage were similarly panned as lacking record support. Moreover, the policy sold to the policyholder in *Mabry* and the policy sold to Royal Capital covered property. The type of property covered (personal property rather than real) was not a principled basis to distinguish the damages available to the policyholder in *Mabry* from the damages that should be available to Royal Capital.

5. **Georgia Supreme Court Ruling**

On May 29, 2012, the Georgia Supreme Court ruled that diminished value can be recovered under a commercial property policy after real property has been damaged and repaired. The court reasoned that the measure of damages for real property was the difference in value before and after the property was damaged. The intent was to place the policyholder, as nearly as possibly, in the same position they would have been if the injury had never occurred. Where repairs do not bring the policyholder’s property back to its pre-damage value, diminished value is allowed. As the court stated:

Although unusual, it may sometimes be appropriate, in order to make the injured party whole, to award a combination of both measures of damages. In such cases, notwithstanding remedial measures undertaken by the injured party, there remains a diminution in value of the property, and an award of
only the costs of remedying the defects will not fully compensate the injured party.

The court referenced common examples of stigma such as infiltration of sewer water, living in a “flood prone area”, or living near a railroad. Other examples (not referenced by the court) might include mold damage, Chinese drywall in the home, and other losses that attract negative public attention.

The court also rejected Maryland’s argument that, under the Loss Payment provision in its policy, it was entitled to elect to “repair” in lieu of paying the “value of the lost or damaged property” without explanation. The court did indicate that causation issues will be significant. If the diminution is to the value of the land and not to the damaged and repaired structure, diminished value may not be appropriate. The loss must be covered and the covered loss must be the cause of the stigma or diminished value.

Likewise, the court indicated that it did not intend to allow the policyholder to “double recover.” If the policyholder has already recovered for the stigma from the alleged tortfeasors(s), then diminished value may not be recovered from the insurer. The supreme court also expressly held that the recovery of diminished value “depends on the specific language of the contract” and that insurers are free to limit or exclude coverage for diminished value or stigma damages.

The ruling in Royal Capital is in accord with the law from certain other states. In D.C., for example, the Court of Appeals has recognized the concept that in a commercial property damage case, a policyholder can recover the diminution of value in lieu of repair costs. See Wentworth v. Air Line Pilots Assoc., 336 A.2d 542 (D.C. 1975).

C. Royal Capital’s Effect

The effects of the Georgia Supreme Court’s application of the Mabry rule to real property are likely to be immediate, both in Georgia and elsewhere. Courts in certain jurisdictions (such
as Florida) are likely to see additional challenges by policyholders with similar policy language. The issue is especially important in the wake of Superstorm Sandy, where much of the coastal damage was suffered in towns and cities with aging real estate. Repairs of such damage may lead to decreased property values. Areas that were once desirable places to live (with accompanying real estate values) may lose their appeal in the wake of the storm. Royal Capital presents an opportunity for policyholders with similar policy language to seek full value for their losses.

This leads to the most challenging aspect of diminished value recovery – how to calculate diminished value. There is already much debate over the oft-maligned “17(c) formula” used to calculate the diminished value of automobiles. Indeed, small claims courts often see suits against insurance companies for miscalculation of diminished value. Even so, most auto diminished value claims are so nominal in amount that they are not litigated because the expenses outweigh any potential recovery. But in the real property context involving million-dollar buildings, parties are much more likely to sue for diminished value, resulting in numerous lawsuits and protracted litigation involving several experts and appraisers.

Extending coverage for post-repair diminution in value will also create a possible concomitant right – and debate – over whether the insurer is entitled to any post-repair increase in value. If a homeowner can claim damages for diminished value in addition to repair costs, does the insurer have the right to offset by any appreciation that results from the repairs?

Another problem is that “diminution in value” is not a defined term in most policies. As a result, its contours are left to the interpretation of insurers, policyholders, and, ultimately, the courts. A policyholder can rightfully claim that “diminution in value” also includes any decrease in personal value of the property that may result from property damage. For example, imagine
that a timber harvester accidentally crosses over a policyholder’s property line and cuts down trees on the property. While the tree removal might actually increase the market value of the home, the loss of shade or ornamental trees could diminish the homeowner’s own perceived value of the house. The danger in finding coverage for an undefined concept like “value” is that it raises questions about how the alleged loss in value is to be measured, from the market’s perspective or from the property owner’s perspective.

Even if coverage for diminution in value is limited to market value, there still exists a question as to what these damages encompass. To the extent a property owner suffers stigma damages because the repaired property is less desirable in the market place, is the policyholder entitled to damages for increased marketing costs? Is he entitled to recover the monthly interest on his mortgage assuming the property takes longer to sell?

Ultimately, however, the issue is best framed as one of causation: does a covered peril set in motion a chain of events leading to a loss of value to real property? If this is the case, and the policy contains no limiting language designed to disrupt the causal link between peril and lost value, such losses are properly covered consistent with the purposes of such policies. On the other hand, the Georgia Supreme Court’s admonition makes clear while the aims of the doctrine may be remedial, the possibility of recovery of diminution in value remains firmly rooted in the policy language. See Royal Capital, 291 Ga. at 267 (“whether damages for diminution in value are recoverable under Royal Capital’s contract depends on the specific language of the contract itself and can be resolved through the application of the general rules of contract construction”). Insurers may view this as an invitation to craft broad policy exclusions designed to eliminate coverage for diminution claims, or seek increases in premiums for risks they previously failed to take into consideration during the underwriting process.
III. CONCLUSION

The effects of Georgia’s ground-breaking decision are yet to be seen, but it will undoubtedly change the way property damage claims are assessed, insured, and adjusted in the future. Policyholders still bear the burden of proving whether and how much diminished value a building or house has sustained as a result of being damaged and repaired. Regardless, as indicated by the Georgia Supreme Court, insurers may find that the best way to avoid paying for diminished value is to include a policy exclusion specifically aimed at eliminating coverage for diminished value. Without such an exclusion, they may well start paying for more than just the cost of repair or replacement.