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Diminution of Value and Property Damage Claims in Georgia

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On May 29, 2012, the Georgia Supreme Court significantly changed the landscape for first-party property insurance claims and claims handling by holding (in *Royal Capital Development, LLC v. Maryland Casualty Company*, 2012 WL 1909842) that a purely economic loss, i.e., diminution of value of property attributable to "stigma" that continues to affect real property even after repairs have restored that property to its original condition, is an element of damage compensable under first-party property coverage. This opinion arose in the context of a response from the court to a certified question from the 11th Circuit Court of Appeals in *Royal Capital v. Maryland Casualty Company*.

Maryland Casualty insured a commercial building owned by Royal Capital. In the course of development on immediately adjacent property, excavation, shoring and pile driving caused cracks in at least the first floor slab of this multistory building (it was disputed between Royal Capital and Maryland Casualty as to whether damage from the work next door extended beyond the first floor slab). Maryland Casualty's insurance contract provided coverage for "direct physical loss of or damage to Covered Property caused by or resulting from a Covered Cause of Loss."

Although Maryland Casualty indemnified its insured for all repair costs associated with the damage to the building, Royal Capital further asserted a significant claim for diminution of value of its building because of the stigma the building now carried from the previous and now-repaired damage. Maryland Casualty denied coverage for this additional claim and prevailed on its coverage position in the U.S. District Court for the Northern District of Georgia (Vinings, J.). On appeal by Royal Capital to the 11th Circuit, the question of whether such a component of loss compensable as "damage" under a property insurance contract was certified to the Georgia Supreme Court.

The court answered the question in the affirmative, essentially holding that diminution of value claims were not limited to auto claims under the court's prior *Mabry*[1] decision but instead extended to essentially any property damage claim: "[a]lthough unusual, it may sometimes be appropriate, in order to make the injured party whole, to award a combination of both measures of damages [cost of repair and diminution of value]. 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," citing *Thurmond & Assoc. v. Kennedy,* 284 Ga. 469, 471 (2003).

The court rejected "Maryland Casualty's contention that the contract at issue did not include coverage for post-repair diminution in value as no insurer or insured had reason to expect such coverage under a standard real property insurance policy." In dicta the court did note that "whether damages for diminution of value are recoverable under Royal Capital's contract depends on the specific language of the contract itself and can be resolved through application of the general rules of contract construction." The Court's explicit adoption of a blend of repair cost and diminution of value, as opposed to a binary choice between repair cost or diminution of fair market value, along with the clear approval of the *Thurmond* holding, suggests that, to the extent that an insurer may be required to indemnify an insured for diminution of value caused by a third party, such indemnity payments would be recoverable in a subrogation action.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact Jefferson C. McConnaughey at jmcconnaughey@cozen.com or 404.572.2056 or Kenan G. Loomis at 404.572.2028 or kloomis@cozen.com

1 In *State Farm Mut. Auto. Ins. Co. v. Mabry*, 274 Ga. 498, 556 S.E.2d 114 (2001), the court held that "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."