

Client Alert

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Georgia Supreme Court Holds That Stigma-Related Loss of Value May Be Covered By First-Party Property Insurance

In *Royal Capital Dev., LLC v. Maryland Cas. Co.*, --- S.E.2d ----, 2012 WL 1909842 (Ga. May 29, 2012), the Georgia Supreme Court held that first-party property insurance policies may cover a loss of property value in addition to the cost of repairs. Answering a question certified to it by the Eleventh Circuit, the Court extended its 2001 decision in *State Farm Auto Ins. Co. v. Mabry*, where the Court held that an automobile insurer was obligated to pay for repair and loss of value to a damaged car, to also apply to commercial buildings.

The decision marks a significant departure from the majority rule that stigma damages and other forms of pure pecuniary loss may not be covered under first-party property insurance because they do not constitute physical injury to tangible property. See, e.g., *Wildin v. Am. Family Mut. Ins. Co.*, 638 N.W.2d 87, 90 (Wis. Ct. App. 2001) (“The common and ordinary meaning of ‘repair’ is ‘restore by replacing a part or putting together what is torn or broken.’ ‘Repair’ is not ordinarily understood to mean to restore to pre-broken or pre-collision market value, as [the insured] argues.”)

The decision also altered the legal landscape in Georgia by expressly overruling the Georgia Court of Appeals’ decision in *City of Atlanta v. Broadnax*, 646 S.E.2d 279 (Ga. Ct. App. 2007), where the intermediate appellate court held that *Mabry* was limited to contracts for automobile insurance and that a more general application of that decision might result in a windfall for policyholders.

Background

In *Royal Capital*, Maryland Casualty Company insured an eight-story commercial building owned by Royal Capital Development, LLC that was physically damaged by construction occurring on an adjacent property. Maryland Casualty acknowledged Royal Capital’s timely filed claim and paid \$1,132,072.96 for the cost of repairing the building. But, Maryland Casualty refused to indemnify Royal Capital for the claimed diminution in value of the building.

Royal Capital filed suit against Maryland Casualty in state court, which Maryland Casualty removed. The district court granted summary judgment in favor of Maryland Casualty, holding that *Mabry* applied only to automobile insurance coverage, and that diminution in value was not covered under contracts insuring real property. Royal Capital appealed to the Eleventh Circuit, which found Georgia law to be unsettled as to whether the holding in *Mabry* applied beyond the context of automobile insurance.

Appeal & Holding

On appeal, the Eleventh Circuit determined that the sole question to be resolved was whether the insurance contract required Maryland Casualty to pay for the alleged diminution in value of the building, in addition to the cost of repair. Recognizing that Georgia state courts had not yet decided that issue, and that a split of authority existed among the federal courts that had addressed it, the Eleventh Circuit certified to the Georgia Supreme Court the following question:

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

Previously, in *Mabry*, the Supreme Court of Georgia recognized in the context of an automobile insurance contract, that diminution in value is an element of loss that may be recovered on the same basis as other elements of loss. The Court reasoned that loss of value damages are sometimes necessary to provide full compensation and that awarding those damages "merely reflects economic reality." Loss of value damages, the Court explained, further the overall objective of placing injured parties back into the position they would have enjoyed had their injury never occurred – a principle that has long been applied under Georgia law when measuring damage to real property. The Court observed that, to fulfill the objective of making the injured party whole, it may be necessary that the party be compensated for both the cost of repairing the damaged property and the difference in value of the damaged property, after it is repaired, from the value of that property prior to the loss. This, the Court concluded, would provide for full recovery.

In *Mabry*, the insurance contract required the insurer to "pay for loss to [the policyholder's] car," but limited the insurer's liability "to the lower of the actual cash value of the vehicle or the cost of the repair or replacement." The insurer in *Mabry* claimed that, if the vehicle had been subject to a "total loss," then it would owe the total cash value of the car, but that it would not owe for any diminution in addition to the repair. The *Mabry* court held that whether any loss of value existed even after the damaged vehicle was fully repaired would be a question of fact for a jury, noting the existence of a "common perception" that a wrecked car is of less value "simply because it was wrecked."

The *Mabry* Court also looked to the contractual purpose of the insurance contract to compensate the policyholder for "actual loss or damage," which Georgia courts have construed to mean the "difference between the value of the property immediately before the injury and its value immediately afterwards." In *Mabry*, the insurer had promised simply to make the policyholder whole. Thus, if the repair did not "return the vehicle to its pre-loss value," then the insurer would also be "obligated to assess [any remaining difference in value] along with the elements of physical damage."

After determining that Georgia law indeed permitted recovery for both physical loss and economic loss where both are necessary to make an insured whole, the Court concluded that the reasoning behind *Mabry* and its Georgia progeny was consistent with the long-standing Georgia rule of contract interpretation that, in the context of an insurance policy that promises to pay for a policyholder's loss, what is lost when physical damage occurs may be both a loss of utility and a loss of value. Further, the Court noted that nothing in *Mabry* or its progeny suggests that the holding in *Mabry* is limited by the type of property insured. Rather, the Court explained, *Mabry* "speaks generally to the measure of damages an insurer is obligated to pay."

Implications

Royal Capital clarifies that, in Georgia, it may not be enough for a property insurer to simply pay its policyholder for identifiable aspects of physical loss. Rather, insurers must assess whether any repairs to physically damaged property can be performed and, if so, whether those repairs put the policyholder into as good a position as the policyholder would have enjoyed had the loss never occurred.

What insurers are ultimately required to pay as to any loss to real property, however, depends on the scope of the promises contained in the contract for insurance. In the event that physical damage causes injury for which a policyholder cannot be fully compensated by repair alone, Georgia law now permits the policyholder to demonstrate a need for additional economic recovery to bridge any remaining gap in value.

Finally, *Royal Capital* also potentially expands the adjustment period by effectively requiring that affected property be reassessed following repairs of the physical damage so that any residual loss of value can be accurately ascertained and compensated. Such a need for post-repair reassessment could, therefore, afford policyholders in Georgia an additional or an extended opportunity to discover areas of latent or hidden damage that might otherwise be overlooked.

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