Auto Insurers Should Reassess Calif. Diminished Value Claims

By **Charles Danaher** (September 20, 2023)

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Before the COVID-19 pandemic, an insurance policy's definition of "property damage" received little attention from the courts.

After the pandemic, however, the definition of "property damage" has generated hundreds of decisions around the country on what the phrase "physical damage to tangible property" actually means. Indeed, in Another Planet Entertainment LLC v. Vigilant Insurance Co., the California Supreme Court will soon decide the meaning of similar policy language.[1]

But what insurance companies may not realize is that the same or similar policy language is implicated in virtually every automobile accident in the state of California.

Auto insurers are often asked by their insureds and third-party claimants to pay for what are known as "diminished value damages" in connection with auto accidents.

Generally speaking, "diminished value" is the loss of market value of a damaged vehicle caused by an accident. Cars that have been involved in accidents are generally worth less than cars that have not. That is one of the reasons Carfax reports exist, identifying whether a particular vehicle has been involved in a significant accident.[2]

In the first-party context, the diminished value claim is typically submitted by the insured for damage to the insured's own vehicle under the policy's collision coverage. In contrast, third-party diminished value claims are typically submitted to the at-fault driver's insurance company under the policy's property damage liability coverage.

In both scenarios, the insurance company is being asked to pay for the diminution in the value of a car by virtue of the fact it was involved in an accident. In the first-party context it is the insured's own car. In the third-party context, it is a car that was damaged as the result of the insured's negligence.

For first-party diminished value claims, the law and policies are clear. Insurance companies do not pay for diminished value damages, and exclusions to that effect are valid and enforceable.[3] Indeed, even before insurers inserted specific diminished value exclusions for first party-property damage claims, courts were generally hostile to such claims.[4]

The more interesting issue is whether a third-party liability insurer must pay for diminished value damages when its insured is at fault for an accident. Many carriers currently pay third-party diminished value claims under the property damage liability coverage because there is no exclusion for such damages.

It is unclear whether an exclusion barring coverage for third-party diminished value damages would be valid under California Insurance Code Section 11580.2, and to our knowledge, no insurance company has attempted to include such an exclusion in their third-party liability coverage — which invariably provides coverage for both property damage and bodily injury damages.

But that does not mean diminished value damages are covered on third-party claims. Under third-party liability coverage, "property damage" is typically defined as "physical damage to tangible property, including destruction or loss of its use."

Courts interpreting California law — such as the U.S. District Court for the Central District of California in two 2019 decisions, Copelan v. Infinity Insurance Co. and Hennessy v. Infinity Insurance Co. — have held that "stigma" or "inherent diminished value" is not covered under this definition.[5] These cases observe, however, that if the vehicle sustains physical damage such that the vehicle cannot be repaired to its preloss condition, the policy may provide third-party property liability coverage for diminished value damages.

Copelan and Hennessy are consistent with older cases applying California law in other contexts.[6]

In New Hampshire Insurance Co. v. Vieira, for example, the U.S. Court of Appeals for the Ninth Circuit, applying California law, addressed whether the diminution in the value of a house due to the faulty installation of drywall constituted property damage under the policy.

In Vieira, a general contractor hired Vieira to install drywall in the rooms and attics of three housing projects.[7] The project owners subsequently sued the general contractor who cross-claimed against Vieira, alleging that he had failed to properly install the drywall.

Vieira's insurer settled the lawsuit and subsequently sought reimbursement against Vieira.[8] The policy defined property damage as "physical injury to or destruction of tangible property."[9]

The Ninth Circuit held that the diminution in value was not covered under the policy because the policy defined property damage as "physical injury to or destruction of tangible property" and Vieira could "point to no physical or tangible damage to the property other than that it [was] defectively installed."[10]

The court rejected Vieira's argument that, even if the diminution in value is not covered damage, separate damage was caused by cutting holes in the roofs to install drywall in the attics. The court held that "the nature of the repairs cannot create coverage where none exists."[11] The Vieira court acknowledged contrary authority, but distinguished it on grounds that the diminution in value in the case before it was not due to "manifest physical damage."[12]

The California Supreme Court's 2001 decision in Kazi v. State Farm Fire & Casualty Co. is also instructive.[13] There, the insureds were sued for impeding on their neighbors' easement through grading they had done on their own property.[14]

The court found that there was no potential coverage under the various policies because the suit sought damages for loss of use of the easement — an intangible property right "akin to goodwill, an anticipated benefit of a bargain, or an investment."[15]

The court observed that "tangible property" refers to things that can be touched, seen, and smelled" and held that diminution in value and intangible economic losses do not constitute physical damage to tangible property. The court also held that the arguable physical injury to the insureds' own property through grading did not "change the character" of the intangible easement right at issue.[16]

Despite the holding in Copelan and Hennessy, a significant number of California auto

insurers currently pay third-party claims for diminished value damages that involve nothing more than "stigma" or "inherent diminished value" damages.

Typically, the third-party claimant will present the liability carrier with a Carfax report showing that the damaged vehicle is worth less after the accident. There are also many companies prominently featured on the internet stating that "inherent diminished value" claims are covered under third-party liability coverage. These companies typically offer to generate a "diminished value" report for a fee. However, they do not inspect the vehicle, so their methodology for determining diminished value damages is unclear.

At least under existing California law, these claims may not be covered.

If, on the other hand, an auto body repair shop legitimately opines that the vehicle cannot be repaired to its preloss condition, only then would diminished value damages be potentially owed in the context of a third-party liability claim.

Best practices dictate that insurance companies differentiate third-party diminished value claims based on stigma damages from those based on the opinion of an auto body repair shop that the damaged vehicle is worth less because it was involved in an accident and cannot be returned to its preloss condition.

The former may not be covered; the latter likely is.

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[1] The California Supreme Court will hear the following coverage question: whether "the actual or potential presence of the COVID-19 virus on an insured's premises constitute[s] 'direct physical loss or damage to property' for purposes of coverage under a commercial property insurance policy." Another Planet Ent., LLC v. Vigilant Ins. Co., 56 F.4th 730, 734 (9th Cir. 2022) (certifying issue to the Supreme Court); Another Planet Ent., LLC v. Vigilant Ins. Co., No. S277893, 2023 Cal. LEXIS 1111, at *1 (Mar. 1, 2023) (accepting the certified question).

[2] According to Carfax's website, it "receives data from more than 139,000 different sources including every U.S. and Canadian provincial motor vehicle agency plus many police and fire departments, collision repair facilities, auto auctions, and more."

[3] See Baldwin v. AAA N. Cal., Nev. & Utah Ins. Exch., 1 Cal. App. 5th 545, 554-55 (2016).

[4] See Ray v. Farmers Ins. Exch., 200 Cal. App. 3d 1411, 1417 (1988).

[5] See Copelan v. Infinity Ins. Co., 728 F. App'x 724, 725 (9th Cir. 2018); Copelan v. Infinity Ins. Co., 359 F. Supp. 3d 926, 928 (C.D. Cal. 2019) (holding no third-party liability coverage for stigma damages); Hennessy v. Infinity Ins. Co., 358 F. Supp. 3d 1074, 1079 (C.D. Cal. 2019) (same).

[6] See New Hampshire Ins. Co. v. Vieira, 930 F.2d 696, 701 (9th Cir. 1991) ("[W]e are persuaded that diminution in value is not 'physical damage' to 'tangible property"'); Goodstein v. Cont'l Cas. Co., 509 F.3d 1042, 1054 (9th Cir. 2007) ("[D]iminution in value does not alone constitute 'property damage' where the policy language requires 'physical injury to tangible property"') (applying Washington law and citing Vieira with approval); see also Scottsdale Ins. Co. v. Pursely, 487 Fed. Appx. 508, 511 (11th Cir. 2012) ("[Plaintiff's] diminished value claim is not cognizable property damage under the policy"). These courts have specifically observed that the insertion of the word "physical" into the definition of "property damage" eliminated any possibility that intangible economic losses could constitute "property damage." Vieira, 930 F.2d at 698-99.

[7] Id. at 697.

[8] Id.

[9] Id.

[10] Id. at 698.

[11] Id. at 701.

[12] Id. at 700.

[13] Kazi v. State Farm Fire & Casualty Co., 24 Cal.4th 871 (2001).

[14] See id. at 875.

[15] Id. at 880.

[16] Id. at 883–84.