RECONCILING THE PRINCIPLE OF INDEMNITY IN DIMINISHED VALUE AUTOMOBILE INSURANCE CLAIMS

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I. INTRODUCTION

The allowance of diminished value payments on automobile repair claims to compensate the vehicle owner for loss of *potential* resale value plus the cost to repair is a broad solution for an indeterminate problem. The solution must be addressed differently for liability claims against an insured, which are governed by tort law for compensation, in contrast to collision claims by the insured, which are governed largely by contract law that looks to the insurance policy provision. The principle of indemnity, inherent in all insurance losses, should be reconciled with these payment schemes, and doing so results in different conclusions.

The principle of indemnity, that insurance should make the insured whole after a loss but not better,[1] is a basic principle of insurance law often overlooked in the controversy for diminished value payments under the first-party collision coverage. We contend that the assertion for diminished value in first-party losses often relies, incorrectly, on using the tort-based liability compensation scheme. Where the owner actually sells the damaged vehicle, then paying the actual reduction in sale price due to the accident is justified to make the insured whole. Where the owner never actually sells the vehicle during any "reasonable period" after the collision, then paying a diminished value amount violates the principle of indemnity because it pays for an unrealized and non-existent loss. Further, the vehicle's value naturally declines to nominal value due to age and obsolescence. Even classifying the diminished value as an unrealized capital loss is a fiction, in part because hardly anyone has a personal balance sheet to reflect the change in one's financial position.

We propose that the diminished value payments controversy on first-party claims can be partially reconciled with the principle of indemnity using a narrower solution that also fits with insurer claims practicalities: payment of diminished value on leased vehicles where this results in an actual cost

[1] "The goal and purpose of indemnity is to reimburse the insured for the insured's actual property loss sustained (restoration, dollar for dollar) but generally no more. The objective of indemnity is to put an insured in the same (but not better) position the insured would have occupied had no loss occurred." 15-111 APPLEMAN ON INSURANCE LAW & PRACTICE ARCHIVE § 111.1 (2d ed. 2011). *Accord* Koppers Co., Inc. v. Aetna Cas. & Sur. Co., 98 F.3d 1440, 1452 (3d Cir. 1996) ("a fundamental principle of insurance law which prohibits insurance contracts from conferring a benefit greater than the insured's loss (i.e., a 'double recovery').").

assessment on the lessee and on vehicles sold within one year of the repair.[2] We also think that the standard Insurance Services Office ("ISO") personal automobile insurance form can be improved upon to solve the differing interpretations, but that does not affect the principle of indemnity issue that has been mostly ignored in the controversy for diminished value compensation for first-party losses.

II. COVERAGE UNDER THE ISO PERSONAL AUTOMOBILE POLICY

Insurance coverage for damage to vehicles under the standard ISO personal automobile policy, 00 01 09 18, provides different definitions for damage to vehicles depending on whether the claim for damages is from a third-party alleging liability by the insured, or for damage from the insured under the collision or comprehensive coverage.[3] This is a starting point to analyze the disputes over coverage; these differences are a matter of contract, not anything inherent in vehicle losses, and contract terms can be changed. The contractual differences still fail to address the fundamental indemnity principle that guides our proposition.

A. ISO COVERAGE FOR LIABILITY LOSSES

The liability coverage under the standard ISO personal automobile policy, 00 01 09 18, states: "We will pay damages for 'bodily injury' or 'property damage' for which any 'insured' becomes legally responsible because of an auto accident."[4] The policy defines "property damage" as "physical injury to, destruction of or loss of use of tangible property."[5] That definition confines any loss payment to actual damage, *or* loss of use (The "*or* loss of use" phrase seems in practice to be conjunctive not disjunctive for what insurers pay on these claims—not exactly what the contract says).

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[2] Our discussion here is limited to automobile claims, which are depreciating assets. We ignore the issue in property loss (i.e., buildings) claims where there is a separate line of pertinent case law. Buildings are different: they are generally appreciating assets when maintained and improvements are made to increase their value, which compels a different analysis than for the depreciating assets of automobiles, although most courts overlook that important distinction. Another category ignored in this paper is collector automobiles, because these are generally insured with a valued policy.

[3] *Personal Auto Policy PP 00 01 09 18*, INS. SERVS. OFF. (2017) [hereinafter *ISO Personal Automobile Policy*].

[4] *Id.* at Liability Coverage Insuring Agreement (A).

[5] *Id.* at Definitions (H).

Those restrictions in payment are what the insurer will pay, even if the insured might be legally liable for more damages, such as for diminished *potential* resale value. Under tort law (as we discuss below), damages can exceed the physical damage repair cost.

There are few cases dealing with diminished value in liability claims. A Massachusetts case addressed this side of the problem, dealing with a different policy as mandated by Massachusetts law, which also required payment for "property damage," but with a broader definition. The approved Massachusetts policy provision in *McGilloway v. Safety Insurance Co.* provided:

> Under this Part, we will pay damages to someone else whose auto or other property is damaged in an accident. The damages we will pay are the amounts that person is legally entitled to collect for property damage through a court judgment or settlement. . . . Damages include any applicable sales tax and the costs resulting from the loss of use of the damaged property.[6]

The *McGilloway* court wrote that '"the term property damage . . . can include intangible damage such as the diminution in value of tangible property."'[7] The court reasoned that tort damages are intended to compensate the injured party for a loss and to put the plaintiff "as nearly as possible equivalent to his [or her] position before the tort."[8]

> Because the plain language of part 4 of the standard policy [cited above] does not limit recovery to merely repair or replacement costs, such recovery must compensate a claimant for any loss of value the claimant incurred as a result of a collision, offset by the increase in value that may occur from repairs to the vehicle. In short, if a third-party claimant's vehicle suffers IDV (inherent diminished valued) even after it is fully repaired, then under part 4 of the standard policy, the insurer may be liable to the claimant for IDV damages so that he or she may be "made whole" once again.[9]

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[6] McGilloway v. Safety Ins. Co., 174 N.E.3d 1191, 1195 (Mass. 2021).
[7] *Id.* at 1196.
[8] *Id.* at 1197.
[9] *Id.* at 1197.

Although the ISO policy limits what it means by property damage, the Massachusetts decision is, to our minds, a fair approach because the property damage is the result of a tort. The insurance covers the tort, the tort damages are to restore the plaintiff, the insurance provides for payment for property damages and thus, restoring the plaintiff should (or can) include diminished value (what the Massachusetts called "inherent diminished value"). This is consistent with the *Restatement of the Law – Torts* § 928:

> Where a person is entitled to a judgment for harm to chattels not amounting to a total destruction in value, the damages include compensation for
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> > (a) the difference between the value of the chattel before the harm and the value after the harm or, at the plaintiff's election, the reasonable cost of repair or restoration where feasible, with due allowance for any difference between the original value and the value after repairs, and (b) the loss of use.[10]

The *Restatement (Second) of the Law – Torts*, is similar.[11]

Thus, under tort law, the controlling source of law when making claims against another driver, the compensation owed is to make the plaintiff whole in all ways and can thus include diminishment of damages.[12] A New Jersey case analogized the stigma to a scarlet letter:

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[10] RESTATEMENT OF TORTS § 928 (AM. L. INST. 1934).

[11] RESTATEMENT (SECOND) OF TORTS § 928 (AM. L. INST. 1979) ("When one is entitled to a judgment for harm to chattels not amounting to a total destruction in value, the damages include compensation for (a) the difference between the value of the chattel before the harm and the value after the harm or, at his election in an appropriate case, the reasonable cost of repair or restoration, with due allowance for any difference between the original value and the value after repairs, and (b) the loss of use.").

[12] *See* Copelan v. Infinity Ins. Co., 728 Fed. App'x. 724, 725 (9th Cir. 2018) ("Although diminution in value is not itself a form of physical damage, it is an accepted way of measuring damage."); *see also* Windham at Carmel Mountain Ranch Ass'n. v. Superior Ct., 135 Cal. Rptr. 2d 834, 844 (Cal. Ct. App. 2003) ("In its common usage, 'damage' includes harm, loss, injury, detriment, or diminution in value."). *See generally* ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 556–59 (6th ed. 2018).

> With the advent of databases such as CarFax, the consuming public now has the ability to learn whether a vehicle wears the "scarlet letter" of an accident history. Because the claims at hand rely on this newly-available source of information doesn't mean the information should be excluded when fixing damages in such a case. To the contrary, we hold that the damage caused by such a "scarlet letter" is just another factor that bears on value and is recoverable if supported by sufficient proof. . . . An award based on this "scarlet letter" or "stigma" is not speculative but is consistent with our past recognition that damages may include such intangible concepts. . . . The "scarlet letter" or "stigma" for which plaintiffs here seek redress fits well within a proper calculus of damage to a motor vehicle.[13]

While the ISO policy form for liability losses does not really embrace such breadth, the insurer probably is responsible for such losses because the insurance policy is approved by the state insurance commissioner and is expected to comply with state law. Where an insurance policy expressly excludes diminishment damages in a liability loss, courts have enforced that restriction.[14] That exclusion leaves the insured to pay that extra liability loss, as uncovered damages.

B. ISO COVERAGE FOR FIRST-PARTY LOSSES

The collision and comprehensive coverage for damages to the insured's own vehicle is defined differently than the liability coverage. Here the ISO insuring agreement in the Personal Automobile Policy states: "We will pay for direct and accidental loss to 'your covered auto' or any 'non-owned auto', including its equipment, minus any applicable deductible

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[13] Fin. Servs. Vehicle Tr. v. Panter, 458 N.J. Super. 244, 250–51 (N.J. Super. Ct. App. Div. 2019).

[14] *See* Hennessy v. Infinity Ins. Co., 358 F. Supp. 3d 1074, 1079 (C.D. Cal. 2019), *appeal dismissed*, Hennessy v. Infinity Ins. Co., No. 19-55266, 2019 WL 2383347 (9th Cir. 2019) ("The policy provides coverage for 'property damage,' meaning 'physical damage to tangible property,' and it clearly and specifically excludes from coverage 'loss . . . [t]o the insured auto for diminution of value,' also known as 'stigma damages.'").

shown in the Declarations."[15] Rather than define "loss" in this section, the policy instead has a "Limit of Liability" section later on that reads:

> A. Our limit of liability for loss will be the lesser of the:
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> 1. Actual cash value of the stolen or damaged property; or
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> 2. Amount necessary to repair or replace the property with other property of like kind and quality.
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> . . .
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> B. An adjustment for depreciation and physical condition will be made in determining actual cash value in the event of a total loss.[16]

Note that these claims do not involve torts subject to principles of compensatory damages. Instead these claims are solely subject to the insurance contract, as some early cases accurately note.[17] Sometimes, of course, the damage to the insured's vehicle may result from a tort by another driver, and thus, the insured could make that additional claim against the other motorist's auto policy, and absent sufficient coverage there, trigger the uninsured motorist coverage part of the policy.[18] Case law in some jurisdictions interpreting this section, dealing with the repair provision, has re-interpreted this compensation to include the diminishment of value. The reasoning of these cases is that:

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[15] *ISO Personal Automobile Policy*, *supra* note 3, at Insuring Agreement (A).

[16] *Id.* at Limit of Liability (A) & (B).

[17] *See generally* Haussler v. Indem. Co., 227 Ill. App. 504, 508–09 (Ill. App. Ct. 1923); U.S. Fid. & Guar. Co. v. Corbett, 35 Ga. App. 606, 610 (Ga. Ct. App. 1926); Gen. Accident. v. Judd., 400 S.W.2d 685, 687 (Ky. Ct. App. 1966).

[18] *See e.g.*, Noteboom v. Farmers Texas Cty. Mut. Ins. Co., 406 S.W.3d 381, 384 (Tex. Ct. App. 2013); Dunn v. Meridian Mut. Ins. Co., 836 N.E.2d 249, 255 (Ind. 2005) ("If an insured incurs damages recoverable from an uninsured motorist beyond the insured's collision coverage, there are 'damages' in addition to the 'loss' that is 'payable' under the Part D collision coverage."); Ibrahim v. AIU Ins. Co., 177 Wash. App. 504, 512 (Wash. Ct. App. 2013); Culhane v. W. Nat'l Mut. Ins. Co., 704 N.W.2d 287, 296–97 (S.D. 2005) ("[T]he contractual indemnification obligation is not governed by Culhane's post-loss feeling of what should be reasonably or rationally covered. Furthermore, Culhane's entitlement to recovery for the 'entire loss' is only applicable under the '[r]ules . . . [of] recovery in tort[, but those rules] do not apply to an action on a contract of insurance.'").

> [T]he term "repair" means restoration of the vehicle to substantially the same condition and value as existed before the damage occurred, so that the correct measure of loss caused by collision is the difference in market value of the automobile immediately before the collision and the combined amount of its market value immediately after being repaired, plus the deductible.[19]

A Washington court distinguished diminution in value damages where the vehicle cannot be restored to its pre-loss condition from stigma damages where the vehicle is restored but bears a "taint."[20] The distinction, however, is not important for this paper. Georgia courts have been especially noteworthy in holding this position, asserting that "repair" includes the amount necessary to restore the vehicle, or more accurately the owner's interest, to the value that preceded the damage. *State Farm Mutual Automobile Insurance Co. v. Mabry* is the most prominent Georgia case on this point:

> [T]he insurance policy, drafted by the insurer, promises to pay for the insured's loss; what is lost when physical damage occurs is both utility and value; therefore, the insurer's obligation to pay for the loss includes paying for any lost value. That interpretation has stood for 75 years in Georgia and has become, therefore, part of the agreement between the parties when they enter into a contract of insurance which includes the promise to pay for the insured's loss.[21]

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[19] 12A STEVEN PLITT ET AL., COUCH ON INSURANCE § 177:19 (3d ed. 2022).

[20] *See Ibrahim*, 177 Wash. App. at 1001–02 ("'Diminished value' damages are available where a vehicle "sustains physical damage in an accident, but due to the nature of the damage, it cannot be fully restored to its preloss condition."") (citation omitted). "One example of this is where weakened metal cannot be repaired. …[U]nlike 'diminished value' damages, stigma damages "occur when the vehicle has been fully restored to its preloss condition, but it carries an intangible taint due to its having been involved in an accident."" *Id.* (citation omitted). "Put somewhat differently, 'diminished value' damages may be available when the vehicle cannot be fully restored to its preloss condition, whereas stigma damages may be available when the vehicle can be fully restored to its preloss physical condition, but is perceived as being less valuable due to the accident.'" *Id.*

[21] State Farm Mut. Auto. Ins. Co. v. Mabry, 274 Ga. 498, 508 (Ga. 2001).

Well, not quite. First, the policy does not agree to pay for loss. Second, the *Mabry* decision cited 75 years of Georgia cases that have required payment of loss of value in addition to the repair costs.[22] That overstates the foundation of the *Mabry* decision. The first case *Mabry* relied on was *U.S. Fidelity & Guaranty Co. v. Corbett*, which was about technical pleading practices to assert a defense of whether the loss of value was properly before the court following an "appraisement" where the insurer did not properly seek to assert the limitation of liability.[23] The second case *Mabry* relied on was *Dependable Insurance Co. v. Gibbs*,[24] which was about an insurer that completed inadequate repairs on the vehicle. Apparently, insurers historically handled the repairs rather than now only paying for them, as is required by law or regulation in many states.[25] The third case was *Simmons v. State Farm* where the court said that the amount the insurer tendered to repair the damaged car seemed to have "the ring of a money settlement rather than an election to repair."[26]

> If the draft on presentation required the payee's signature to a release of all claims, this would be the only possible result, but, in any event, the communications from the insurer show that it intended for the insured to rely on the guarantee of the repairman, but failed to show that such a guarantee had in fact been made.[27]

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[22] *Id.* at 503–06.

[23] *See* U.S. Fid. & Guar. Co. v. Corbett, 134 S.E. 336, 338 (Ga. Ct. App. 1926) ("under the provisions of the policy now under consideration, 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 [citation omitted] 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.*") (citation omitted) (emphasis added). Since the insurer had failed to do so at the appraisement, it could not then assert it in the lawsuit. *Id.*

[24] *See* Dependable Ins. Co., Inc. v. Gibbs, 127 S.E.2d 454, 460 (Ga. 1962).

[25] *See e.g.*, CAL. CODE REGS. tit. 10, § 2695.85(c) (2022); CONN. GEN. STAT. § 38a-354 (2022); GA. CODE ANN. § 33-34-6(b) (West 2022).

[26] *See* Simmons v. State Farm Mut. Auto. Ins. Co., 143 S.E.2d 55, 58 (Ga. Ct. App. 1965).

[27] *Id.*

Regardless of the distortion, the *Mabry* decision, and some cases from the 1970s and 1980s that were cited by *Mabry*, established that in Georgia, the repair option includes the diminishment in value condition.

The Washington Court of Appeals has also allowed for diminishment of value damages, explaining in *Moeller v. Farmers Insurance Co*. that:

> A vehicle suffers diminished value when it sustains physical damage in an accident, but due to the nature of the damage, it cannot be fully restored to its pre-loss condition. Weakened metal that cannot be repaired is one such example. In contrast, 'stigma damages' occur when the vehicle has been fully restored to its pre-loss condition, but it carries an intangible taint due to its having been involved in an accident.[28]

Moeller agreed with the policyholder that '"like kind and quality"' in the policy means "a restoration of *appearance*, *function*, and *value*" and thus, includes diminishment of value.[29]

Many states reject this interpretation and (to our mind) stick with a proper and conventional interpretation of the contract language. The Delaware Supreme Court in *O'Brien v. Progressive Northern Insurance Co*. rejected the claimant's approach (and by extension, the Georgia approach) that "repair" includes "financial detriment."[30]

> [T]he claimed loss cannot be interpreted without an accompanying examination of all of the policies' limits on liability, which were contracted to by all of the involved parties . . . the policies in question give the insurer the option

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[28] Moeller v. Farmers Ins. Co., 229 P.3d 857, 861 (Wash. App. Div. 2 2010), *aff'd*, 267 P.3d 998 (Wash. 2011). The court's contention is not accurate. If the metal is weakened, then the structural integrity is deficient and it should be repaired to replace the weak metal, and if that cannot be done—such as having to replace the chassis—then the vehicle should be junked. This seems to be the view of the few cases that have allowed diminished value damages where repairs were inadequate or there was a delay in repair. *See* Campbell v. Calvert Fire Ins. Co., 109 S.E.2d 572 (S.C. 1959); Venable v. Import Volkswagen, 519 P.2d 67 (Kan. 1974); Pierce v. Am. Fid. Fire Ins. Co., 83 S.E.2d 493 (N.C. 1954).

[29] *Moeller*, 229 P.3d at 863.

[30] *See* O'Brien v. Progressive N. Ins. Co., 785 A.2d 281, 287 (Del. 2001).

> of either reimbursing the claimant for the entire value of the damaged automobile or of repairing or replacing its parts, depending on which will cost the insurer less. A reading of the policy language as Appellants suggest would render this "choice" meaningless.[31]

A California court explained that, "'[p]re-loss condition' means the 'preaccident safe, mechanical and cosmetic condition' of the covered vehicle."[32] The court continued, "an insurer's election to repair is conclusive 'provided the repair places the automobile substantially in its preaccident condition.'"[33] If it does not, then the automobile is deemed a total loss, and

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[31] *Id.* at 287. Noteworthy is the court's rebuke of the claimant's typical contention that a split of authority among the states is evidence of ambiguity of a contract provision.

> Appellants argue that the mere fact that a number of courts nationwide have reached different and contradictory conclusions about the meaning of policy terms nearly identical to those before us in this case creates an ambiguity. This contention, while seductive, is without merit. … The duty of the courts is to examine solely the language of the contractual provisions in question to determine whether the disputed terms are capable of two or more reasonable interpretations. In so doing, Delaware courts are obligated to confine themselves to the language of the document and not to look to extrinsic evidence to find ambiguity. A mere split in the case law concerning the meaning of a term does not render that meaning ambiguous in the Delaware courts.
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> This Court would place itself in an untenable position if it were to recognize every split in judicial authority as *prima facie* evidence of ambiguity. In the context of interpreting insurance agreements, an adoption of this policy would unduly restrict the power of the Delaware courts to render decisions independent of our sister courts. . . . If this Court were to allow an insured to demonstrate ambiguity by providing evidence of a split in authority, *contra proferentem* would preclude us from even addressing the contract language or the merits of the case.

Id. at 289.

[32] Carson v. Mercury Ins. Co., 210 Cal. App. 4th 409, 420 (Cal. Ct. App. 2012).

[33] *Id.* at 421.

the insurer is liable for the preaccident value of the car."[34] An earlier case was more explicit, stating that there is no requirement "to repair the automobile to both its pre-accident condition *and* market value."[35]

Several treatises set out the arguments for and against allowing for diminishment in value compensation, citing to case law, in trying to interpret what "repair" and "quality" mean in the standard policy and the standard fallback of the insured's reasonable expectation as to what these might mean.[36] An insured's idea of reasonable expectations is itself subject to debate, controversy, and legal fiction given that insureds seem to expect everything from an insurance policy whenever there is a loss—despite having no understanding of insurance and never reading an insurance policy.[37] Whether an insured who never reads a policy, falls within the large category of financially illiterate consumers, and buys solely on price not

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[34] *Id.* at 421 (citing Ray v. Farmers Ins. Exch., 200 Cal. App. 3d 1411 (Cal. Ct. App. 1988)).

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

[36] *See generally* JEFFREY W. STEMPEL & ERIK S. KNUTSEN, STEMPLE AND KNUTSEN ON INSURANCE § 27.08 (2020); STEVEN PLITT ET. AL., 12A COUCH ON INSURANCE 3D § 177:19 (2022); 16 WILLISTON ON CONTRACTS § 49:20 (4th ed. 2022); Thomas O. Farrish, *"Diminished Value" in Automobile Insurance: The Controversy and its Lessons*, 12 CONN. INS. L.J. 39, 57–59 (2005).

[37] A credible attack on the concept is in Susan M. Popik & Carol D. Quackenbos, *Reasonable Expectations After Thirty Years: A Failed Doctrine*, 5 CONN. INS. L.J. 425, 426 (1998). An earlier summary of the evolution of the doctrine, adoption, and criticism of reasonable expectations is in Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 826–27 (1990). As Henderson notes, "reasonable expectations" is not necessary to the core idea of construing ambiguities against the drafter of the contract, *contra proferentem*. *Id.* Of course, an insurance policy that provides unusually restricted coverage from what might be called an industry standard policy, where that distinction is not brought to the attention of the insured, warrants protection. This was the case in C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 169 (Iowa 1975), where the burglary cause of loss had the uncommon restriction that there must be evidence of visible marks of entry on the exterior. Henderson notes that this provision was in other policies to deal with employee dishonesty losses. Henderson, *supra*, at 845–49. On the duty to read, and failure thereof, see 16 WILLISTON ON CONTRACTS § 49:21 (4th ed. 2022) and Harold Weston, *Insured's Duty to Read Insurance Policy as Affirmative Defense in Claims Against Insurance Agents and Brokers*, 8 AM. L. REP'S 6th 549 (2005).

content can even be said to have a reasonable expectation is a separate and much longer debate not germane to this article.[38]

Unusual facts may require both repair and compensation, such as where the car is stolen and considerable mileage is added to the vehicle although the actual repairs are nominal.[39] The table below shows the general breakdown of jurisdictions that allow or reject diminished value claims for vehicle damage and split between third-party (liability) claims and first-party (collision and comprehensive) claims. The table is not necessarily complete, and many additional cases can be listed beyond the few collected here.[40]

[38] Likewise not germane here is an analysis of the distinctions between personal lines insurance policies from other consumer contracts and the need for consumer protection. The articles about insureds not reading their policies are too long to even begin to list a few here.

[39] *See* Ciresi v. Globe & Rutgers Fire Ins. Co., 244 N.W. 688, 689 (Minn. 1932); Superior Pontiac Co. v. Queen Ins. Co., 434 S.W.2d 340, 340 (Tex. 1968); Ray v. Farmers Ins. Exch., 200 Cal. App. 3d 1411, 1420 (Cal. Ct. App. 1988); Edwards v. Md. Motorcar Ins. Co., 204 A.D. 174, 175 (N.Y. App. Div. 1922); Fanfarillo v. E. End Motor Co., 411 A.2d 1167, 1169 (N.J. Super. Ct. App. Div. 1980).

[40] *See e.g.*, STEMPEL & KNUTSEN, *supra* note 36; L.S. Tellier, Annotation, *Measure of Recovery by Insured Under Automobile Collision Insurance Policy*, 43 A.L.R. 327 (1955); J. Randolph Evans et al., *Insurance Coverage for Post-Repair Diminution in Value: Trends in Automobile and Real Property Claims* (Lexis 2011).

	States that allow for diminished value in auto claims	**State that disallow for diminished value in auto claims**
3d party liability	District of Columbia; Oklahoma; Massachusetts; West Virginia.[41]	Massachusetts; Oregon.[42]
1st party collision & comprehensive	Georgia; Mississippi; Oregon; Rhode Island; Washington[43]	California; Florida; Illinois; Louisiana, although in this case, the insurer's policy expressly excluded diminution in value; Kentucky; Ohio; Maine; Massachusetts; Michigan; Mississippi; Missouri; New Jersey; New Mexico; South Carolina; South Dakota; Tennessee; Texas; Virginia.[44]

[41] Am. Serv. Ctr. Assocs. v. Helton, 867 A.2d 235, 243 (D.C. 2005) (citing to the Restatement); McGilloway v. Safety Ins. Co., 174 N.E.3d 1191, 1196 (Mass. 2021); Brennen v. Aston, 84 P.3d 99, 102 (Okla. 2003); Ellis v. King, 400 S.E.2d 235, 239 (W. Va. 1990).

[42] Martins v. Vt. Mut. Ins. Co., 411 F. Supp. 3d 166, 172 (D. Mass. 2019) (predicting Massachusetts law). *See also* Dunmire Motor Co. v. Or. Mut. Fire Ins. Co. 114 P.2d 1005, 1009 (Or. 1941).

[43] Calvert Fire Ins. Co. v. Newman, 124 So. 2d 686 (Miss. 1960); Gonzales v. Farmers Ins. Co., 196 P.3d 1 (Or. 2008); Pawtucket Mut. Ins. Co. v. Gay, 786 A.2d 383 (R.I. 2001); Moeller v. Farmers Ins. Co., 229 P.3d 857, 861 (Wash. App. Div. 2 2010), *aff'd*, 267 P.3d 998 (Wash. 2011).

[44] Copelan v. Infinity Ins. Co., 728 Fed. App'x 724 (2018); Baldwin v. AAA N. Cal., Nev. & Utah Ins. Exch., 204 Cal. Rptr. 3d (Cal. Ct. App. 2016); Ray v. Farmers Ins. Exch., 246 Cal. Rptr. 593 (Cal. Ct. App. 1988); Hennessy v. Infinity Ins. Co.,

The ISO form seems clear enough on what the contract says, though it could do better by defining the damage to be paid (repair or actual cash value) rather than splitting this idea in a separate section on limitation of liability.[45] Debating the point further here will not advance the debate nor resolve the question. Courts that reject or distort the contract provision for first-party coverage can impose (as a matter of public policy but not as honest contract interpretation) an additional compensation. Our goal is not to provide a solid matrix on jurisdictional outcomes but to address these outcomes under the principle of indemnity, which we do in the next section.

III. THE PRINCIPLE OF INDEMNITY IN INSURANCE

The principle of indemnity is fundamental to insurance,[46] it '"is the basis and foundation of all insurance law,"'[47] though not stated within actual contracts. "This legal principle operates independently of any agreement between the parties."[48] It is "the concept that insurance contracts shall confer

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358 F. Supp. 3d 1074, 1079 (C.D. Cal. 2019) (policy excluded diminished value as damages); Siegle v. Progressive Consumers Ins. Co., 788 So. 2d 355 (Fla. Dist. Ct. App. 2001), *decision approved*, 819 So. 2d 732 (Fla. 2002); Sims v. Allstate Ins. Co., 851 N.E.2d 701 (Ill. App. Ct. 2006); Gen. Accident Fire & Like Assurance Corp. v. Judd, 400 S.W.2d 685 (Ky. 1966); Sandoz v. Bourgeois, 64 So. 3d 322 (La. Ct. App. 2011); Gehrisch v. Chubb Grp. of Ins. Cos., 645 Fed. App'x 488 (6th Cir. 2016); Hall v. Acadia Ins. Co., 801 A.2d 993 (Me. 2002); Given v. Com. Ins. Co., 796 N.E.2d 1275 (Mass. 2003); Driscoll v. State Farm Mut. Auto. Ins. Co., 227 F. Supp. 2d 696 (E.D. Mich. 2002); Blakely v. State Farm Mut. Auto. Ins. Co., 406 F.3d 747, 753 (5th Cir. 2005) (distinguishing earlier cases with different policy language); Lupo v. Shelter Mut. Ins. Co., 70 S.W.3d 16 (Mo. Ct. App. 2002); Kieffer v. High Point Ins. Co., 25 A.3d 1206 (N.J. Super. Ct. App. Div. 2011); Davis v. Farmers Ins. Co., 142 P.3d 17 (N.M. Ct. App. 2006); Schulmeyer v. State Farm Fire & Cas. Co., 579 S.E.2d 132 (S.C. 2003); Culhane v. W. Nat'l Mut. Ins. Co., 704 N.W.2d 287 (S.D. 2005); Black v. State Farm Mut. Auto. Ins. Co., 101 S.W.3d 427 (Tenn. Ct. App. 2002); Am. Mfrs. Mut. Ins. Co. v. Schaefer, 124 S.W.3d 154 (Tex. 2003). *See also* State & Cnty. Mut. Fire Ins. Co. v. Macias, 133 S.W.3d 271 (Tex. 2004); Bickel v. Nationwide Mut. Ins. Co., 143 S.E.2d 903 (Va. 1965).

[45] *See generally ISO Personal Automobile Policy*, *supra* note 3.

[46] *See* Koppers Co., Inc. v. Aetna Cas. & Sur. Co., 98 F.3d 1440, 1452 (3d Cir. 1996).

[47] Rochester Am. Ins. Co. v. Short, 252 P.2d 490, 493 (Okla. 1953) (quoting McAnarney v. Newark Fire Ins. Co., 159 N.E. 902, 904 (N.Y. 1928)).

[48] Letoha v. Nationwide Ins. Co., No. 06-CV-1009, 2007 WL 4557864, at *1 (S.D. Miss. Dec. 20, 2007).

a benefit no greater in value than the loss suffered by an insured."[49] The principles of adverse selection and moral hazard are not stated in insurance contracts either, but they, along with indemnity, underpin and suffuse the business and commitment of insurance to restore the insured to a position similar to but no better than had the loss not occurred—provided that the insurance policies cover such losses. The principle of indemnity can help resolve the contention for loss of value because it will force open the question of whether the loss of value is realized or unrealized (to use accounting terminology).

Robert H. Jerry, II in *New Appleman on Insurance* explains the principle of indemnity:

> In its simplest usage in insurance, the term "indemnity" refers to the compensation necessary to reimburse the insured's loss. One goal of an insurance transaction is to transfer the insured's risk of loss to the insurer. When the insured suffers a loss, the insurer pays proceeds, a benefit, to the insured in an amount that offsets the loss. This arrangement is based upon the assumption that the value of the benefit paid the insured will not exceed the amount of the loss; that is, insurance aims to reimburse and to do nothing more. It is consistent with the *principle of indemnity* to pay the insured a benefit *less than* the loss, but the *principle of indemnity* is violated if the insured is paid a benefit greater than the loss.
>
> Property insurance is fundamentally a contract of indemnity. Property values are relatively easy to measure, and property insurance is oriented toward reimbursing the impairment of a property's value.[50]

As Jerry notes, replacement cost coverage in building losses seems to violate the principle of indemnity "because the insured has an improvement through use of new materials," which leads to a repair

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[49] Teague-Strebeck Motors, Inc. v. Chrysler Ins. Co., 985 P.2d 1183, 1193 (N.M. Ct. App. 1999), *overruled on other grounds by*, Sloan v. State Farm Mut. Auto. Ins. Co., 85 P.3d 230 (N.M. 2004).

[50] ROBERT H. JERRY, II, 1 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 1.05 (2021) (emphasis in the original). *See also* Gossett v. Farmers Ins. Co. of Wash., 948 P.2d 1264, 1271 (Wash. 1997) (further explaining indemnity).

"indemnified in a functional way."[51] This is always a challenge to the idea of replacement cost and repair, because it replaces new for old of similar kind and quality.[52] More accurately, that often means removing the depreciation of labor and materials from the actual cash value calculation,[53] and in some respects, it is not feasible to replace with exactly the same old materials: imagine trying to find 15-year-old roof shingles in a junkyard, lumber from a demolition site to do the basic frame carpentry, and an old dingy carpet to match what the policyholder had.

The same problem occurs in automobile repair cases. Old parts are replaced with new ones. The radiator that was developing rust and thin spots is now new, the fogged headlamps are now new, and so on and will last much longer than the original worn parts. Yet still the market value for a vehicle repaired from an accident is lower. As Thomas Farrish notes, "appellate courts seem almost ready to take judicial notice of the proposition that cars lose value regardless of how well the repairs might have been performed."[54]

James Athearn in his treatise on insurance gives a different definition:

> Insurance is a contract of indemnity. The insurer agrees to pay for loss suffered by the insured, and no more. The purpose of the contract is to shift the burden of risk from the insured to the insurer. The insured is to be restored to the same economic position he occupied prior to the loss. In no event is his position to be improved as a result of the loss and his agreement with the insurer. Indemnity agreements have

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[51] JERRY, *supra* note 50, at n.71.

[52] ALLAN D. WINDT, INSURANCE CLAIMS AN DISPUTES § 11:35 (6th ed. 2013) ("Replacement cost coverage, therefore, in contravention of the general rule that an insured cannot profit through insurance, results in the insured being better off than he or she was prior to the loss, since the insured ends up with a more valuable property.").

[53] *See e.g.*, Arnold v. State Farm Fire & Cas. Co., 268 F. Supp. 3d 1297, 1305 (S.D. Ala. 2017); Shelter Mut. Ins. Co. v. Goodner, 477 S.W.3d 512, 515 (Ark. 2015); Sproull v. State Farm Fire & Cas. Co., 184 N.E.3d 203, 210–16 (Ill. 2021) (collecting cases for and against depreciating labor); Wilcox v. State Farm Fire & Cas. Co., 874 N.W.2d 780, 785 (Minn. 2016) ("When a homeowner's insurance policy does not define the term 'actual cash value' or otherwise state whether embedded labor costs are depreciable for the purpose of calculating actual cash value, the trier of fact may consider embedded-labor-cost depreciation when such evidence logically tends to establish the actual cash value of a covered loss.").

[54] Farrish, *supra* note 36, at 50.

> practical significance for the insurer and for society as a whole. If the insured could gain by having a loss, many would be tempted to cause losses. . . . Any contract of insurance that makes it possible for the insured to profit is contrary to public policy and poor business for the insurer.[55]

This definition would embrace both the actual cost to repair the vehicle, and the economic loss that diminishment of value damages allow—except we are back to the question whether that extra compensation makes the insured better off than he or she would be. Indisputably, replacing new for old parts is an improvement, but that is the cost to repair and, as Jerry notes above, insurers have accommodated themselves to the reality that replacing new for old is part of the deal to restore the insured to the pre-loss condition.[56] Extra money, however, is not old for new.[57] Taking Athearn at his word, restoring the insured to the economic position he or she was in pre-loss would require only payment of the amount of that was the fair market value of the vehicle seconds before the impact.

Engaging the principle of indemnity to analyze this problem of compensable loss brings to the surface several features of the problem of diminished value in automobile claims: whether the insured has actually suffered a loss by the drop in value that can comply with the principle of indemnity.

A. DOES THE INSURED SUFFER A COMPENSABLE LOSS CONSISTENT WITH THE PRINCIPLE OF INDEMNITY?

Disregard the insuring agreements for first-party losses to deal here with a principle, not policy language; besides, the policy language can be changed. One answer is yes, there is a compensable loss, which is allowed under *tort* law, but that moves this back to a liability loss. These diminished value cases to compensate an insured arise from the indemnity principle, not from tort law. A vehicle that was in a collision and was repaired has a stigma and results in a lower resale value, which *can* be a compensable loss. The real question at the core is whether there *is* a loss if the insured does not sell the vehicle. This raises several points: What are the accounting rules for recognizing changes in value of damaged, and repaired, assets? When should an unrealized capital loss be recognized for a consumer? Is this an economic loss or a property loss?

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[55] JAMES L. ATHEARN, RISK AND INSURANCE 59 (1962).
[56] JERRY, *supra* note 50, at n.116.
[57] Farrish, *supra* note 36, at 70.

Basic accounting instructs that a loss is realized when the asset is sold (or disposed of) and the price is lower than the carrying cost, what it was valued at on the books and reflecting depreciation.[58] A loss is recognized when the event occurs, even if there is no sale of the asset (or receipt of cash for some asset or service).[59] Thus, a damaged vehicle would recognize a loss in the value of the asset, a repaired vehicle would cancel that out (if we are to make immediate accounting entries), and the diminished (stigma) fair market value would be recognized on the books if the asset is marked to market price even though the vehicle is not sold and no loss is realized.

Vehicles are depreciating assets, losing value due to time, wear, and mileage. A business owner can deduct the depreciation of the asset,[60] and there are specific tax depreciation schedules for various assets, including vehicles,[61] which can be different from Generally Accepted Accounting Principles (GAAP).

Most vehicles for consumers are purchased, operated, and maintained. Some people will "customize" a vehicle to improve the sound system, tires, rims, parts of the suspension, or engine with aftermarket parts, which, if significant, will raise the value. For consumers, these improvements create challenges in figuring out the right insurance limit and should increase any market value *if the vehicle is sold.* The vehicle, even at the higher value, then begins its decline in value. For consumers, unlike businesses, there is no *recognition* of any accounting event of this higher value for the balance sheet because there is almost never a consumer balance sheet (except when applying for a loan). For consumers, absent a sale, there is no loss or gain to *realize* the relevant market value against the carrying cost after depreciation plus any capital improvement to the asset.

Even if a consumer replaces an engine or transmission, which are expensive items, the event would in theory *recognize* a higher carrying value of the vehicle than what the vehicle was worth before the improvement, in part because this would be a capital replacement. In practice, consumers have no balance sheet on which to recognize this. This raises the insurance indemnity problem of what the right indemnity value is when an insurer replaces high-value items that increase the market price. Here, some policies allow an insurer to deduct the value of the betterment where it increases the value of the vehicle; thus, the example if an insurer replaces an engine

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[58] *Lesson 2: Realization vs Recognition*, ACCOUNT. BASICS (Sep. 3, 2014), https://accountingbasics.lifestylecpa.com/realization-vs-recognition/.

[59] *Id.*

[60] I.R.S. PUBL'N 946, HOW TO DEPRECIATE PROPERTY (2022).

[61] *Id.* at 59.

damaged by some covered peril (flood or collision, for example) that had 40,000 miles on it, now with a new engine, that new engine raises the market value of the car from the value with a 40,000 mile engine. That extra value may be deducted from the cost of repairs.[62]

Fair market value is the usual insurance equivalent of actual cash value.[63] This also reflects supply and demand for comparable vehicles regardless of ordinary depreciating value due to mileage, year, wear and tear, and any diminished or stigma value. This is a key point that in 2021 and 2022 raised the value of used cars due to the computer chip shortage for new cars.[64]

This connects the debate on whether the insured has a compensable loss or not. Where the insured does not sell the vehicle or have a balance sheet to reflect assets and consequent book value, there is a theoretical accounting loss only. Theoretical because in fact the insured has no accounting records or financial statements to display the value.

The absence of accounting records and financial statements is important but perhaps not definitive. Either the value exists regardless of whether a financial statement reflects it or the value does not exist, because there is no reason to record or reflect any such value. Consumers are generally aware of the values of their homes and the resale values of their cars. They do not need financial statements to know and to worry about those values. That does not mean, however, that they have a loss if those values decline. As Jeffrey Stempel observes:

> But accepting the idea that auto insurance should pay for diminished post-crash/post-repair market value runs counter to the social function of auto insurance. Auto collision

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[62] Andrew Janquitto, *The Insurer's Payment Obligation and Limitation*, *in* 6 NEW APPLEMAN ON INSURANCE LAW § 62.08 at 1, 12–13 (2022).

[63] *Id.* at § 62.08[b]. *See, e.g.*, Williams-Diggins v. Permanent Gen. Assurance Corp., 157 N.E.3d 220, 225 (Ohio Ct. App. 2020); Pannell v. Mo. Ins. Guar. Ass'n, 595 S.W.2d 339, 355 (Mo. Ct. App. 1980); Lowery v. Fid. Nat'l Prop. & Cas. Ins. Co., 805 F.3d 204, 210 (5th Cir. 2015). STEVEN PLITT ET AL., 12 COUCH ON INSURANCE § 175:24 (3d ed. 2022) ("Courts, in applying and interpreting the standard 'actual cash value' provision, have adopted several rules or tests in arriving at the extent of the insurer's liability, and it is the purpose of the subsequent sections to point out these various tests or rules.").

[64] *See* Matt Phillips, *Dealers Pay Record Prices for Used Cars, Reversing a Trend That Pointed to an Easing of Inflation*, N.Y. TIMES (Oct. 13, 2021), https://www.nytimes.com/2021/10/07/business/used-car-prices.html; Matt Phillips, *Wall Street Scans the Lots as Used Cars Prod Inflation*, N.Y. TIMES (Oct. 13, 2021), https://www.nytimes.com/2021/09/27/business/used-cars-inflation.html.

> insurance is designed to restore a damaged vehicle to its pre-accident condition. If, after a collision, the insurer pays for an adequate repair that restores the auto to its prior condition, the insurance policy has achieved its purpose.
>
> Imposing on the insurer the additional burden of paying for any loss of market value the car may have sustained, merely because it was in an accident, goes beyond the intended social purpose of collision insurance and turns auto insurance, designed to protect against the economic consequences of physical damage, into something of a price guarantee bond.[65]

A second feature that connects the diminished value question in first-party losses to the principle of indemnity is whether there is a property loss or an economic loss. A property loss can be fixed by repairs. The cause of the property loss is some damage either due to an insured peril as addressed by property insurance owned by the insured or property loss due to some negligent or intentional conduct by another party as addressed by the liability side of the insurance for that other party (leave aside the insured's own intentional destruction of the property and the exclusion in the insurance for that). A property loss requires repair or replacement of the damaged property. That is what the insurance contract agrees to do for the insured. The Texas court in *Carlton v. Trinity Universal Insurance Co.* noted this important distinction in rejecting diminution in value damages for damage to the insured's vehicle:

> [W]e do not consider what measure of recovery would make the insured whole after a loss or what would be fair and reasonable compensation for the loss he sustained, for we are not deciding a tort claim. Because the parties' rights and obligations are governed by the contract between them, we instead focus on the plain, unambiguous language of the insurance policy and the ordinary meaning of the words defining the parties' obligations.[66]

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[65] Jeffrey W. Stempel*, The Insurance Policy as Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489, 1562–63 (2010).

[66] Carlton v. Trinity Universal Ins. Co., 32 S.W.3d 454, 464 (Tex. Ct. App. 2000).

Other courts have also adhered to the insurance contract and its limit of liability provision to reject reading into the word "repair" some extra value. For example, the court in *Schulmeyer v. State Farm Fire & Casualty Co.* stated: "In the context of an insurance contract the word 'replace' means the insurer will 'restore the insured's vehicle to a former place or position,' or 'take the place of . . . as a substitute or successor.'" [¶] There is no concept of value in the ordinary meaning of these words."[67] The court in *Driscoll v. State Farm Mutual Automobile Insurance Co.* stated:

> [T]he language of the provisions themselves expressly limit coverage to the *lesser* of the actual value or the cost of repair. This is not ambiguous language. The insured must pay for either the actual value of the car or the cost of repair, whichever is less. These are alternatives and do not include the addition of an obligation to pay for diminished value to the car. Reading into the cost of repair a requirement to also pay for diminished value would render the limitation provision meaningless, as the insurer would essentially always pay for the value of the car. [68]

That differs from the damages owed due to the tort when someone else is at fault, in third-party liability claims, where the claimant is entitled under tort law to recover all resulting damages, especially in cases where the repairs cannot restore the property to its pre-loss condition.[69] This is consistent with

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[67] Schulmeyer v. State Farm Fire & Cas. Co., 579 S.E.2d 132, 153 (S.C. 2003) (internal citations omitted). *See also* Culhane v. W. Nat'l Mut. Ins. Co., 704 N.W.2d 287, 291–92 (S.D. 2005).

[68] Driscoll v. State Farm Mut. Auto. Ins. Co., 227 F. Supp. 2d 696, 707 (E.D. Mich. 2002).

[69] *See* Merch. Shippers Ass'n v. Kellogg Express & Draying Co., 170 P.2d 923, 926 (Cal. 1946) (quoting Byrne v. W. Pipe & Steel Co., Cal. App. 270, 274 (Cal. Ct. App. 1927)) (concerning machinery that was damaged, stating that '"if the damaged property cannot be completely repaired, the measure of damages is the difference between its value before the injury and its value after the repairs have been made, plus the reasonable cost of making the repairs.'"). The court further noted that:

> It appears that the machine was a precision machine and that the repairs which were made did not restore it to its former state with no depreciation in its former value. There was evidence showing that the value of the machine after it was repaired was much less

the liability insurance side of the auto policy, which defines property damage "for which any 'insured' becomes legally responsible because of an auto accident."[70] That "*because of an auto accident*" phrase is not limiting, unlike the collision side of coverage that has a "limitation of liability" provision. That phrase embraces every aspect of the loss "because of an auto accident." Tort law reflects this, as discussed earlier.

An economic loss is different; it arises either from a breach of contract (not relevant in auto liability accident cases), or from some tort, such as another party's misrepresentation or falsehood or failure to perform. Both situations provide the remedy of benefit of the bargain damages or out-of-pocket damages.[71] Dodd describes these as "economic entitlement damages" in discussing common law and equitable torts, though the same principle applies in contract claims.[72] Dodd explains that where one party has misled another party as to the condition or value of a good or property, the plaintiff must "prove a loss" but does not also have to "realize a loss."[73] Moreover, "[t]hat is, they do not require the plaintiff to re-sell the purchased goods at a loss, to pay for repair or upgrading of the goods, or to suffer any kind of physical injury as a result of the item's poor qualities."[74] The Texas decision discussed above in *Carlton v. Trinity Universal Insurance Co.* also noted this and cited to a 1928 third-party case, *Milby Auto. Co. v. Kendrick*,[75] involving a tort claim for diminution in value in addition to the repairs made. The court recognized the potential for such recovery but disallowed the diminution part because the repairs restored the vehicle to its pre-accident market value.[76]

> than before the injury; that the repairs did not put it in such condition of working efficiency as would sustain a guarantee by the manufacturer; that the machine would still have to be completely overhauled and tested, preferably at the factory, before it would give satisfactory precision service in accordance with its design; that even when so overhauled and adjusted, it would nevertheless remain a secondhand machine on the market; and that this type of machine was 'slow moving' on the market because of the limited demand.

Merch. Shippers Ass'n, 170 P.2d at 927.

[70] *See ISO Personal Automobile Policy*, *supra* note 3.

[71] DAN B. DODD ET AL., THE LAW OF TORTS § 694 (2d ed. 2018).

[72] *Id. See also* Kieffer v. High Point Ins. Co., 422 N.J. Super. 38, 47–48 (N.J. Super. Ct. App. Div. 2011).

[73] DODD, ET AL., *supra* note 71.

[74] *Id.*

[75] Milby Auto. Co. v. Kendrick, 8 S.W.2d 743, 744 (Tex. Ct. App. 1928), *writ dismissed w.o.j.*, (Jan. 30, 1929).

[76] *Id.*

> [T]he amount paid by the appellee for repairs to his automobile was the reasonable necessary cost of restoring it to its condition immediately prior to its injury by appellant. It occurs to us that there could be no more accurate method of ascertaining the damage caused appellee by appellant's negligence than the reasonable necessary cost of restoring the injured automobile to its condition prior to its injury, thereby giving it the same value it possessed immediately before its injury. Such measure of damages conforms to the one fundamental rule, applicable in all cases of negligent injury, which entitles the injured party to fair and reasonable compensation for the loss sustained, and is not in conflict with the general rule that the measure of damage is the difference in the market value of the injured property before and after its injury. If the injured property is restored to its condition prior to its injury, its market value would ordinarily be restored, and the cost of such restoration would be identical with the difference between its market value before and after its injury.[77]

The problem with paying diminished value damages when the insured does not sell the vehicle is that he or she now has a cash payment for an unrealized and probably never-to-be-realized loss. That seems to violate the principle of indemnity in insurance and the fundamental concept of damages "that compensation, not enrichment, is the basis for the award of damages."[78] A Georgia court rejected a claim for loss of income in addition to the actual damages done to a telephone transmission line where there was no evidence for such loss of income, and stated that there was no evidence of any such loss to require compensation: "the purpose of damages is to put the aggrieved party in the position, as near as possible, as he or she would have been without the injury or damage."[79] Another Georgia court, being specific to automobile claims, allowed for damages to include "the value of

[77] *Id.*
[78] MCI Commc'ns Servs., Inc. v. CMES, Inc., 291 Ga. 461, 463 (Ga. 2012).
[79] *Id.* at 464.

any permanent impairment."[80] Note that "permanent impairment" might be different from diminished value.

A fair argument against this payment even in liability cases is that the claimant does not sell the vehicle. Yet tort law does not require that the loss be realized in an accounting sense, only realized in a legal sense.

IV. RECONCILING THE PRINCIPLE OF INDEMNITY TO DIMINISHMENT OF VALUE IN AUTO CLAIMS.

If diminishment damages are to be allowed under the current policy language for first-party losses, then we think a better approach would be to consider what really makes the insured whole for a loss. If the insured actually sells the car within one year or returns the leased car whenever due and the lessor imposes a charge for damage against the policyholder, then the loss in value is real and being realized—the insured should be compensated for that. That actually makes the insured whole and is consistent with the principle of indemnity.[81] A Washington court addressing a property loss claim under a builder's risk policy, which loss was paid under an arbitration agreement with another party, said "[u]nder the indemnity principle of insurance, an insured receives only that amount that will indemnify actual loss, not an additional windfall above this amount."[82] To

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[80] T & T Transp. v. Duckworth, 864 S.E.2d 181, 183 (Ga. Ct. App. 2021), *reconsideration denied*, (Nov. 15, 2021). *See e.g.*, Sykes v. Sin, 493 S.E.2d 571, 574 (Ga. Ct. App. 1997).

[81] *See* Fernandez v. State Farm Mut. Auto. Ins. Co., 338 F. Supp. 3d 1193, 1199 (D. Nev. 2018) (requiring actual payment of benefits for a UIM clause to apply). *Cf.* Pan Pac. Retail Props., Inc. v. Gulf Ins. Co., 471 F.3d 961, 973–74 (9th Cir. 2006) ("[I]f Western was fully compensated by Pan Pacific's indemnification agreement and never made any payments itself, then Western should not obtain double recovery from Twin City based on its multiple agreements for indemnification. California case law states that an insurer may offset its contractual obligation to pay the insured against any previous payments made by other parties that have already compensated the insured for its loss").

[82] MKB Constructors v. Am. Zurich Ins. Co., 49 F. Supp. 3d 814, 826 (W.D. Wash. 2014). The point was developed in asbestos cases and other long-tailed toxic tort cases where multiple policies could be triggered to pay a loss; courts have limited the recovery to only the actual loss regardless of the number of policies. This is a complicated problem for how to allocate losses across multiple policies—all sums versus pro rata allocation—beyond the scope of this article. See Keene Corp. v. Ins. Co. of N. Am., 667 F.2d 1034 (D.C. Cir. 1981) and EnergyNorth Nat. Gas, Inc. v. Certain Underwriters at Lloyd's, 934 A.2d 517, 521–27 (N.H. 2007) for a

allow the insured there to recover both from the contracting party and the insurer "would be seeking a double recovery and a significant windfall, in violation of the most basic principle of insurance."[83] As noted earlier, replacement cost coverage can result in a benefit that improves the insured's position.[84] Consider too that collateral source payments by other parties can result in double recoveries.[85] A Texas case dealing with water damage to a home that was later sold emphasized the need for there to be an actual pecuniary loss reflected in the sale, not a hypothetical loss.

> [A]n insurer cannot be required to pay its insured more than the amount of his actual loss . . . there is no pecuniary loss when the loss has been made good out of a related transaction." . . . . In other words, courts should "analyze the reality of a loss" by '"look[ing] to the substance of the whole transaction rather than to seek a metaphysical hypothesis upon which to justify a loss that is no loss.'" In so doing, courts should aim to prevent windfall recoveries in which insureds who ultimately suffer no pecuniary loss are still entitled to recover under their insurance policies.[86]

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discussion of this problem. *See also* Eaton Corp. v. Westport Ins. Co., 567 F. Supp. 3d 1029, 1037 (E.D. Wis. 2021) ("under the all-sums allocation method, Eaton may select a policy year, allocate its covered losses to that year, and work its way up the coverage tower for that year. . . . If Eaton could allocate the same loss to multiple policy years, then Eaton would be recovering twice for the same loss. Yet the all-sums allocation method does not entitle Eaton to a double recovery").

[83] *MKB Constructors*, 49 F. Supp. 3d at 826–27. *See also* Koppers Co., Inc. v. Aetna Cas. & Sur. Co., 98 F.3d 1440, 1452 (3d Cir. 1996).

[84] *See supra* text accompanying notes 52–53.

[85] See Gustafson v. Cent. Iowa Mut. Ins. Ass'n, 277 N.W.2d 609, 612–14 (Iowa 1979), discussing the New York Rule versus the Wisconsin Rule, where the New York Rule imposes the obligation upon the happening of the insurable event, and thus, it does not allow an insurer to offset its payments under a property policy by what any third-party owes for a loss. The decision notes the many jurisdictions that have adopted either Rule. *See also* Montgomery v. First Nat'l Bank, 508 P.2d 428, 435 (Or. 1973) ("We would ignore the intentions of the parties to the insurance contract if we permitted the insurance company, or defendant bank, who can assert no greater rights than the insurance company, to claim the benefit of subsequent collateral events such as the repair of the building by the owner").

[86] Johnson v. Safeco Ins. Co., 240 F. Supp. 3d 555, 562 (N.D. Tex. 2017) (citations omitted).

If, however, the insured does not sell the car within one year, then the book value of the car is mostly irrelevant to the insured. To pay for the additional loss of value is a bonus and violates the principle of indemnity.

We recognize that our one-year cut-off is arbitrary. A cut-off must be arbitrary, and claims must be resolved and not left open for 5 years or whenever the insured actually sells the vehicle. One year to submit a supplemental claim for diminished value somewhat aligns with the insurer accounting principle of accident year when determining loss ratios. The sale must be arms-length. It is easy to imagine collusion occurring in a sale among some family member or friend, raising the cost of claims administration and insurance fraud investigations over a few hundred or maybe a few thousand dollars. This risk might be sufficient to compel an insurer to make a business decision to pay some extra compensation to close a file. We deal here, however, with the principle of indemnity not individual business decisions.