Automobile Diminished Value Claims

Brenda P. Wells-Dietel[1]
Asligul Erkan-Barlow
William Walkowiak[2]

OVERVIEW This study explains the concept of diminished value in automobile insurance, along with the various state laws and cases that affect these types of claims and how they are handled. Among different diminished value types, our research focuses on the inherent diminished value due to its subjective nature. Additionally, we identify the existing methods for determining diminished value and some intangible considerations contributing to this loss. In summary, there are variations in the diminished value loss determination due to inconsistencies in the contract language and case laws. Since vehicles are more expensive to purchase and repair in current economic circumstances, diminished value claims will likely remain a concern. As a result, the information presented in this paper provides compelling reasoning to invite regulators, courts, and lawmakers to consider that insurers may want to exclude these losses from the coverage forms, therefore, provide better guidance to make these claims easier to predict for insurers and allow for more certainty.

WHAT IS DIMINISHED VALUE? To illustrate the concept of diminished value, a hypothetical example is presented as follows. Suppose a consumer is in the market for a car and finds two 2010 Mustangs for sale. The two vehicles are identical in model, color, features, and price. If the individual discovers that one was wrecked and repaired a few years earlier, the one never involved in an accident will most likely be chosen. The previously damaged car, regardless of how well it has been repaired, is perceived to be worth less than an identical but has never been damaged vehicle. Thus, even if the car is completely restored, there is a perceived reduction in value. This is an example of diminution in value, also called and hereafter referred to as "diminished value."

CONCLUSIONS The state courts in the United States have varied on how diminished value losses are determined and paid. The calculation of these losses is also quite variable depending upon the source asked to determine the loss. Based on an average expected diminished value loss of 10 to 20 percent of the direct property damage amount, it is easy enough for insurers to calculate an actuarially fair premium that covers this loss. Georgia is the only state with a clear legal direction that first-party auto claimants are entitled to recover the diminished value losses from their automobile insurers. Regarding third-party claims, insurance providers should be prepared to pay diminished value losses in many states. That said, Georgia's established "17(c)" formula for calculating diminished value is not sound and well-received. Although the value loss is calculated as a percentage of the total repair costs, the latter's determination

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ABSTRACT

This paper discusses the diminished value concept in automobile insurance and examines the variances in state laws regarding first- and third-party diminished value claims. The factors that impact diminished value are identified, including certain intangible factors that cannot be measured or quantified. The existing methods employed for calculating diminished value are presented. In conclusion, insurance providers, regulators, courts, and lawmakers are invited to further consider the topic of interest and make adjustments to improve the predictability of diminished value claims.

Keywords: Diminished value, diminution in value, automobile insurance

1. Department of Finance and Insurance, College of Business, East Carolina University, Greenville, N.C., eenvB(ollet.Flr)12hini0o

1. Introduction

This study explains the concept of diminished value in automobile insurance, along with the various state laws and cases that affect these types of claims and how they are handled. Among different diminished value types, our research focuses on the inherent diminished value due to its subjective nature. Additionally, we identify the existing methods for determining diminished value and some intangible considerations contributing to this loss. In summary, there are variations in the diminished value loss determination due to inconsistencies in contract language and case laws. Since vehicles are more expensive to purchase and repair in current economic circumstances, diminished value claims likely will remain a concern. As a result, the information presented in this paper provides compelling reasons for insurers to exclude these losses from coverage forms, and regulators, courts, and lawmakers should consider these reasons, as excluding these losses would provide better guidance, allow claims to be easier to predict for insurers, as well as give insurers more certainty.

2. What Is Diminished Value?

To illustrate the concept of diminished value, here is a hypothetical example. Suppose a consumer is in the market for a car and finds two 2010 Mustangs for sale. The two vehicles are identical in model, color, features, and price. If the individual discovers that one was wrecked and repaired a few years earlier, the one never involved in an accident will most likely be chosen. The previously damaged car, regardless of how well it has been repaired, is perceived to be worth less than an identical vehicle that has never been damaged. Thus, even if the car is completely restored, there is a perceived reduction in value. This is an ex (he 529.8961 nueduction in v3.6461 Tm7 ysie ident

or trade-in value offered. It is even possible that a dealership will not accept the car for trade-in at any amount.[4] It is at this juncture that the actual diminished value is realized. There are certainly arguments against paying for diminished value losses. According to one perspective, the loss does not exist or occur until the vehicle is sold. If the claimant is not selling the vehicle, the loss is not experienced or incurred. Other opponents argue that paying diminished value claims may inflate the cost of auto claims and raise auto insurance prices for everyone.

Ultimately determining whether insurance contracts must cover diminished value claims is at the discretion of each state. Laws on what must be paid for by standard automobile insurance coverages differ across state lines. A significant amount of case laws across the country will be discussed subsequently. First, it is essential to note that what is required to pay in a diminished value loss claim varies significantly with the type of claim involved: first party or third party. Weston and Wells-Dietel (2023) note that the two types of claims must be handled differently to reconcile the concept of diminished value with the principle of indemnity.

Figure 1: ISO PAP Limi, f Liabili,

LIMIT OF LIABILITY

A. Our limit of liability for loss will be the lesser of the:

1. Actual cash value of the stolen or damaged property; or

2. Amount necessary to repair or replace the property with other property of like kind and quality.

However, the most we will pay for loss to:

1. Any “non-owned auto” which is a trailer is $1500.

2. Electronic equipment that reproduces, receives or transmits audio, visual or data signals, which is permanently installed in the auto in locnals, the u 3Ded

Note. Copyright ISO, 2018., Personal Auto Policy Form # PP 00 01 01 05)

First-Party Claims

A first-party claim is filed by the insured (the first party) against their own auto insurance policy. Because the actual contract language binds the insurer and the insured, the

4. The first author’s collegiate dean experienced this problem when his automobile suffered $300 in damages. The at-fault party’s insurance company paid to repair the damages and reported them to a claims database (these are discussed later in the paper). When the dean went to trade the car for another vehicle, the dealership searched its VIN in the database and found the car had been repaired in the past. The dealership refused to accept the vehicle for trade-in at any value.

settlement of these claims hinges on how the policy is worded. The language in the Insurance Services Office's (ISO's) personal auto policy (PAP) is specific to this issue.[5]

The language of interest is the limit of liability condition under part D, "Damage to Your Auto." This condition, shown in Figure 1, does not mention diminished value as being a covered portion of a first-party collision other than collision loss. Even so, interpreting this first-party coverage depends significantly on case law because insurance is a contract of adhesion. A contract of adhesion is written entirely by one party and presented to the other on a "take it or leave it" basis. In the case of such contracts, the law requires ambiguities in the wording to be interpreted against the maker of the contract (Rejda et al., 2020). It should also be noted that some insurers do not use the ISO form but have a manuscript or amended coverage forms. Analysis of those policies is beyond the scope of this paper. ISO also offers an endorsement to exclude the diminished value losses. The endorsement is PP 13 01, "Coverage for Damage to Your Auto Exclusion Endorsement."

Insurers wishing to avoid payment of diminished value losses in first-party claims can use this endorsement where allowed. Generally, when this endorsement is used, the corresponding PAP will not cover first-party diminished value claims.

There has been considerable variation in how courts have interpreted the meaning of the first-party contract language in the PAP. A few states have not considered the issue at all. Other states have only addressed diminished value concerning real property claims regarding homes or buildings and have yet to consider the PAP's contract language explicitly.[6] For a relatively up-to-date summary of state laws pertaining to diminished value (both first- and third-party claims), refer to Diminution in Value Cases in All 50 States (Matthiesen, Wickert & Lehrer, S.C., 2022). Some courts have concluded that the wording regarding loss payment is unambiguous, and as such, diminished value losses are not compensable in first-party PAP claims. In the Florida case of *Siegle v. Progressive* (2002), Siegle had a collision and asked Progressive to pay for the damages. As is standard in a PAP, the insurer had the contractual option to repair or replace the property or pay the actual cash value of the automobile. Progressive chose to repair the damages. Afterward, Siegle sued the insurance provider asking for the difference between the pre-accident value of the auto and its value after it was repaired. Both trial and supreme courts ruled that the contract was clear in its intent and that the insurer was not obligated to pay the diminished value loss.[7]

Similar conclusions have been reached in other states. In *American Manufacturers Mutual Insurance Company v. Schaefer* (2003), the Texas Supreme Court held that the obligation of the insurer was limited to that specified in the policy's limit of liability provisions (to pay the actual cash value or pay for repair/replacement). The California Court of Appeals in *Ray v. Farmers Ins. Exchange* (1988) stated, "We will not rewrite an otherwise unambiguous limitation of collision coverage to provide for a risk not baros[((Twi48 (or (1w 9 10 3 Tc -0c4ns.05 Twiinally r) Twished .04 M8 (ot of)-2 .04C)12 (our

on third-party diminished value claims is much less defined than that of first-party claims since the wording of the insurance contract does not dictate a third party's rights. Instead, the third party has recovery rights in tort. The *Restatement of Torts* notes that:

> "Where a person is entitled to 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 the plaintiff's election, the reasonable cost of repairs or restoration where feasible, with due allowance for any difference between the original value and the value after repairs."[9]

Many states allow recovery for the diminished value of a damaged vehicle in a third-party claim, including Arizona, Colorado, Florida, Georgia, Illinois, Indiana, Iowa, Louisiana, Maryland, New Mexico, New York, Oregon, South Carolina, and Virginia (Matthiesenet al., 2022). In *Cassella v. Lenches* (2010), Connecticut affirmed the right of a third-party claimant to recover diminished value losses following an accident. Cassella's vintage Corvette was struck by another car driven by Lenches. Cassella was awarded $10,000 as compensation for the diminished value loss due to his car no longer being in pristine, undamaged condition.

One unique situation is an insured person filing a property damage claim under the uninsured motorist (UM) coverage (Part C) of the PAP. It should be noted that not all auto insurance policies provide property damage coverage under UM coverage, and it can also vary across states and insurers. Sometimes it is automatically provided; in other cases, the insured must specifically request coverage. In that case, the insured is indeed a first-party claimant, but the coverage is designed to mimic the liability coverage of an at-fault third party. According to Edwin Allen,[10] a licensed, multi-lines claims adjuster, (personal communication, 2023), in such cases, the insured is treated as a third-party claimant under the PAP and is entitled to present a diminished value claim to the insurer. In either type of diminished value claim (first or third party), the burden of providing proof of loss is on the plaintiff/claimant. In some states or with some insurers, the burden of proof is high. Documenting and proving the diminished value loss may require a professional appraiser's expertise. The following section summarizes the major factors that influence diminished value determination.

4. Factors Affecting Diminished Value

Damage and Repair History

The damage and repair history of a vehicle plays a significant role in determining its sales price or trade-in value. How many times the car has been involved in an accident and what damage it sustained should be known before determining its fair market value. The type of damage the vehicle suffers is critical because cosmetic damage does not result in as much of a diminished value perception as severe structural damage does. The quality and type of repairs made to the vehicle are also important. While

9. Restatement of Torts § 402 (Am. Law Inst. 1934)

10. Name changed per the request of the claims adjuster interviewed.

high-quality and sound artistry can significantly reduce the perception of diminished value, lower-quality and inferior repairs can substantially increase it.

There is an inherent information asymmetry between the buyers and sellers of most properties, and vehicles are no exception. As the potential buyer discovers, information about previous damages and repairs may not be fully disclosed by the seller of a vehicle. Several methods could be used to mitigate this lack of transparency in automobile sales, such as disclosure laws, onboard technology, third-party

communication, 2023), insurers use this database primarily in the automobile insurance underwriting process.

CARFAX

CARFAX's website notes that it receives data from 34,000 sources, including "every U.S. and Canadian provincial motor vehicle agency plus many police and fire departments, collision repair facilities, auto auctions, and more." CARFAX notes that its reports may not be complete: "… we do not have all accidents as many have never been reported, or may only have been reported to a source to which CARFAX does not have access." (CARFAX, n.d.-a). Insurers do not typically report to CARFAX but can do so if they choose (Allen, personal communication, 2023). Consumers must supply a VIN to obtain a CARFAX report on a particular vehicle and pay a fee for the report. The reports cost $44.99 for one report, $64.99 for three, and $99.99 for five (CARFAX, n.d.-b).

AutoCheck

AutoCheck, owned by Experian, provides a service that is similar to CARFAX. Consumers must supply a VIN to request a report on a particular vehicle's history. According to the AutoCheck website, its reports are compiled from hundreds of sources, including state motor vehicle departments (DMVs), auto auctions, Canadian motor vehicle departments, consumer protection agencies, auto dealers, and other state agencies. A report for one vehicle costs $24.99, or (for)]TJ0 (ce 5410 0 0 10 66 0 0 10 66 0)173.ection tehicle cost(n

diminished value, along with dealer testimonials on how the physical damage will affect the automobile's trade-in and resale values.

Intangible Factors

Allen (personal communication, 2023) indicates that numerous intangible and subjective factors affect diminished value. For instance, cars are more of a status symbol today than in decades past. This is because of the growing number of people who cannot afford to buy a home due to the economic downturn. The automobile, in turn, has become more of a status symbol. Further, since someone's car is seen by more people than their house, the car becomes a reflection of who they are. Therefore, the more valuable a person views their car, the higher the perceived diminished value will also be after an accident. Further, the information the person has obtained about diminished value also impacts the perception of loss and can vary significantly from one claimant to another. For example, one claimant may obtain a car dealer's opinion about the trade-in value before the accident and after the repairs were made. Meanwhile, another might hire an independent appraiser to evaluate the damage. In both cases, the information obtained may inflate the estimated diminished value.

5. Diminished Value Calculations

To our knowledge, existing literature established by academic researchers and industry experts fails to present a consistently accepted method to determine the diminished value loss. Unfortunately, a standard formula for calculating the loss does not exist either. North Carolina law outlines a method for insurance providers and insured individuals to settle disagreements about diminished value without using the court system. This statute provides that if the insured and insurer disagree on the diminished value by more than $2,000 or 25% of the auto's fair market value, each shall select and pay an independent appraiser to value the loss. If they still cannot reach an agreement, a third appraiser is called in to render a final and binding verdict on the value (Motor Vehicle Liability Policy, n.d.). But, the valuation process (determination of the actual dollar amount) is still subject to substantial subjectivity and professional judgment. The currently available methods are summarized below.

In recent years there has been an increase in the number of websites offering diminished value appraisal services (Barone, 2010). For example, a consumer portal (Automall Network Inc., n.d.) provides a valuation service to help insured individuals determine their vehicles' diminished value for a $45 fee. It also offers a "concierge" service to assist with claim settlement, including expert testimony and other related services. However, the diminished value calculation formula is proprietary and unavailable for evaluation. The websites that provide this type of diminished value assessment typically charge in one of two ways: a flat fee or a percentage fee. The percentage fee is more controversial because the price is an increasing function of the settlement amount, which, in return, compromises the appraiser's disinterest in compiling a diminished value figure (Barone, 2010).

Historically, Georgia has employed the 17(c) formula, which is:

$$\textit{Diminished Value} = 0.1 * (\textit{NADA Retail Value}) * \textit{Damage Modifier} * \textit{Mileage Modifier}$$

The value of the modifiers used in this formula ranges from zero to one. For example, moderate damage would result in a 0.5 damage modifier being applied to the formula (Bryant et al., 2013). The 17(c) formula is controversial because mileage is already factored into the National Automobile Dealers Association (NADA)[11] retail value. Consequently, the application of the mileage modifier is viewed by some as a double penalty for mileage. Moreover, the formula does not include an actual post-loss inspection that would adjust for variances in repair quality (Bryant et al., 2013; Kielich, 2013).

Some claimants hire an independent licensed appraiser at their own cost to assess the diminished value loss. According to one appraiser's website, "There is no one-size-fits-all approach (to determine the diminished value), since every vehicle depreciates differently, depending on various factors, such as market demand, brand, and manufacturing quality" (Autoloss, 2014). Again, the process is somewhat subjective. Allen (personal communication, 2023) indicates that in "the real world" of claims settlement, the diminished value loss ultimately ends up being about 10% to 20% of the direct physical damage loss. For example, a $10,000 repair bill would likely result in a diminished value claim between $1,000 and $2,000. Because of these relatively low values, attorney involvement in diminished value claims is rare. These claims are often small enough to qualify for adjudication in small claims court, where attorneys are typically not permitted to assist a plaintiff.

6. Conclusion

State courts have varied on how diminished value losses are determined and paid. The calculation of these losses is also quite variable depending upon the source asked to determine the loss. Based on an average expected diminished value loss of 10% to 20% of the direct property damage amount, it is easy enough for insurers to calculate an actuarially fair premium that covers this loss. Georgia is the only state with a clear legal direction that first-party auto claimants are entitled to recover the diminished value losses from their automobile insurers. Regarding third-party claims, insurance providers should be prepared to pay diminished value losses in many states. Georgia's established 17(c) formula for calculating diminished value is not sound and well-received. Although the value loss is calculated as a percentage of the total repair costs, the latter's determination can be subjective and vary by the insurer, the location,

claims. Regarding third-party claims, where permitted, the aggrieved party must do research and documentation to prove diminished value. Better guidance from court decisions, laws, and regulations could make these claims easier to predict for insurers and allow for more certainty. As it stands now, this can be a contentious process the authors have witnessed many times.

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