



NOVEMBER 2010

The Stigma of an Accident Aircraft: Can an Insured Recover for Alleged Post-Repair Diminution in Value of an Aircraft?

In a depressed used aircraft market, or even one that is now showing signs of recovery, an aircraft that sustained physical damage in an incident can be a hard sell despite the damage being repaired and the aircraft restored to airworthy condition. Following an incident resulting in physical damage, an insured owner/operator may seek to recover under its hull policy for not only the direct physical damage to its aircraft, but also the harm to the resale value of the aircraft. Two recent cases illustrate insureds' arguments to recover such intangible damage and the benefit of an express exclusion of the same.

Diminution in Value Beyond Cost to Repair Aircraft Covered Where Court Viewed Definition of 'Physical Damage' as Ambiguous

U.S. District Court, District of Idaho

In *Center Capital Corporation v. National Union Fire Insurance Company of Pittsburgh, Pa.*, No. 1:09-cv-471-CWD, 2010 WL 3941933 (D. Idaho Oct. 5, 2010), the U.S. District Court for the District of Idaho concluded that an aircraft hull policy was ambiguous and therefore reasonably subject to an interpretation allowing the recovery of diminution in value. Following an incident in which the insured's aircraft sustained damage while taxiing, the insured commenced a declaratory judgment action against National Union alleging it was entitled to compensation for diminution in value beyond the actual cost to repair the aircraft. The insured argued that in order to be made whole, it is not enough to merely repair the aircraft, because even after the repair the aircraft will no longer be the same quality as before the accident. National Union contended that the covered loss does not include diminution in value.

The policy provided that the most National Union would pay for a covered loss not involving a total loss was the "costs to repair or replace damage with materials of like kind and quality." The term "loss" was defined as "physical damage," which in turn was defined as "direct and accidental physical loss of or damage to property (also called loss). Excluded are depreciation, or any damages for loss of use."

Agreeing with the insured that the policy was ambiguous, the court rejected National Union's argument that the limitation of coverage to "physical damage" and the costs to repair or replace such damage precluded coverage for diminution in value. The court observed that the term "damage" generally can have several meanings and that diminution in value is one accepted measure of damage to property. Nevertheless, the policy's definition of physical damage, while excluding depreciation and loss of use, did not expressly exclude diminution in value. In addition, while acknowledging that "physical" unambiguously excludes subjective damage such as diminution in value, the court read the policy's definition of "physical damage" to broadly include "damage to property," which in the court's view could include diminution in value.

The court found that this purported ambiguity carried over to the policy's settlement options, where two of National Union's options were to "(i) pay you, or (ii) repair or replace damage with parts of like kind and quality" According to the court, the first option – payment to the insured – was not quantified, but must have a meaning different than the second option to "repair or replace" so as not to render the second option redundant. Thus rejecting National Union's argument that any payment is measured by the cost of repairs, the court interpreted the first option as providing for payment of the "loss" and referred again to the definition of "loss," which it previously found did not exclude diminution in value.

Despite obvious flaws in the court's reasoning such as limiting the modification of the word "damage" by "physical," the court's criticism of the policy turned upon the lack of an express exclusion for diminution in value.

Aircraft Not Rendered a Total Loss Where 'Physical Damage' Definition Excluded Residual Decrease in Value After Repairs

U.S. District Court, Eastern District of Missouri

In *CNS Corporation v. Global Aerospace, Inc.*, No. 2:10CV18 JCH, 2010 WL 2978063 (E.D. Mo. July 23, 2010), the U.S. District Court for the Eastern District of Missouri rejected the insured's argument that the diminished value of its aircraft following repairs rendered it a total loss.

The insured's aircraft, a Raytheon Premier 1, was damaged when it slid off an icy runway. The repair estimates for airframe and engines totaled \$3,462,709. However, in connection with its estimate of repair costs, the aircraft's manufacturer, Hawker Beechcraft, noted that additional damage may be discovered once repairs were started. Further, in addition to the repairs being recorded in the aircraft's logs, some of the repairs would be apparent on visible inspection. Presumably seeking to limit its own potential liability, the manufacturer cautioned that the repairs may result in increased inspection requirements and operating limitations. In sum, the manufacturer warned that, while the repairs would return the aircraft to airworthy condition, they could nevertheless have a negative effect on the aircraft's resale value.

Consequently, the insured alleged the aircraft was a total loss because it could not be restored to as good a condition as it was before the loss and sought the aircraft's insured value of \$5.5 million. Global, however, only paid the repair estimate of \$3,462,709 and agreed to pay for the repair of additional damage discovered during the repair process. Global also invoked the policy's appraisal clause to have the repair costs determined by an umpire.

The insured commenced a declaratory judgment action contending that the appraisal clause was inapplicable because the aircraft was a total loss. According to the insured, a complete repair was not possible as the aircraft could not be restored to its pre-accident condition. The dispute was therefore alleged to be one of coverage, not simply repair costs, and that post-repair issues such as the alteration of the aircraft's appearance and operational limitations were beyond the scope of an appraisal.

The court rejected the insured's claim because the policy's definition of "physical damage" expressly excluded "loss of use or any residual decrease in value after repairs have been made." The court also relied on prior Missouri cases holding that diminished value is not recoverable under an automobile policy where adequate repairs have been made. Accordingly, because diminution in value was not properly considered in the calculation of the insured's loss, the case centered on repair costs only and the insurer was entitled to invoke the appraisal clause.

About this Newsletter

Sedgwick's *Aerospace Insurance Update* is a periodic review of notable insurance law case decisions addressing issues pertaining to the aviation and aerospace industry. It is prepared by attorneys from our [Aerospace Coverage Practice Group](#).

If you are not already on our list but would like to receive future issues of this or other Sedgwick publications, please [click here](#).

For further information, please contact:

[Andrew T. Houghton](#)

Partner, New York
tel: 212.422.0202
andrew.houghton@sdma.com



Disclaimer: This communication is published as an information service for clients and friends of the firm, and is made available with the understanding that it does not constitute the rendering of legal advice or other professional service. Some jurisdictions require that we label this material "Attorney Advertising." Any discussion of prior results does not guarantee a similar outcome.

© 2010 Sedgwick, Detert, Moran & Arnold LLP. All rights reserved.