

By John S. Kenefick

The distinction between stigma and diminution in value and a familiarity with your jurisdiction's decisions are key.

Understanding Stigma Damage Claims

Several years ago, when we were relocating to Texas, my wife and I found a beautiful house in a pleasant subdivision. It was the right size and layout. It had a nice yard, a pool and a great kitchen. It was also very well priced.

But, we passed. Why? Well, it turned out that the house had foundation problems. They had been repaired, and the sellers provided a detailed report from a professional engineer who stood behind the method and quality of the repair. So the problem had been identified, analyzed, repaired and fully disclosed. Still, we felt uneasy enough to decide not to buy the home.

Let us consider the situation from the sellers' point of view. We will assume that they had built the house for \$150,000. We will also assume that the repair cost \$20,000 for engineering, materials and labor. When the sellers put the house on the market, they listed it for \$210,000, while other nearby houses of similar size and quality, but without a history of foundation problems, listed for \$225,000. Assuming that the sellers could still bring a timely cause of action against their builder, do they have a winner?

Certainly they are out-of-pocket \$20,000, which is a relatively straightforward claim. But the more difficult question is whether

they could recover the difference between their lower selling price and the list price of similar houses, or \$15,000. Can that constitute damage?

Recently, there have been widely reported stories concerning Chinese-manufactured drywall. Reportedly, drywall made in China and installed in homes in the United States is now causing problems. An Internet search reveals not only hundreds of news articles on the topic, but also dozens of attorney sites, presumably hoping to develop cases from the plaintiff's side.

According to the Consumer Product Safety Commission (CPSC), it has received over 180 reports from residents in 13 states and the District of Columbia who believe health symptoms or the corrosion of certain metal components in their homes are related to the presence of drywall produced in China.

The CPSC reports that common complaints about homes believed to contain problematic drywall include a "rotten egg" smell in their homes, irritated and itchy



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eyes and skin, difficulty breathing, persistent coughs, bloody noses, runny noses, recurrent headaches, sinus infections and asthma attacks. Reportedly, homeowners have also complained of blackened and corroded metal components in their homes and frequent replacement of components in air conditioning units. In article after article, complaining homeowners report fear that the presence of Chinese drywall will negatively impact home values. It is the classic stigma damage scenario, and accompanying claims will likely follow.

What are the potential outcomes for these claims? In construction defect cases, the law has struggled with these cases, known generally as “stigma” damage cases.

What Is Stigma?

Stigma is defined as something that detracts from character or reputation. Related to real property, stigma refers to an intangible negative impact on the value or marketability due to increased risk or future uncertainty. Many states have mandatory disclosure requirements for real estate transactions that generally ensure that all parties are aware of latent defects or prior damage. Certainly, disclosure of prior damage, even though it is repaired, may result in a discounted price. Buyers may face difficulties securing a mortgage or insurance. When a defect is associated with infestation or geotechnical or structural problems, a buyer may never be comfortable that he or she will not experience the same problems in the future.

Stigma vs. Diminution

The biggest misconception in these cases in the context of construction defects is that the stigma and diminution in value are the same. Courts often use the terms “diminution in value” and “stigma damages” interchangeably. This is unfortunate, because understanding the distinction is essential in these cases to correctly measure damages. Diminution in value is best thought of as the measure of decreased value for an unrepaired property, while stigma damages are tort damages awarded for reduced property value due to a negative public perception, whether rational or not, *in addition* to recovery for physical injury to the property. In other words, stigma damages

are sought when an award for the cost of the repair for the damage will not make a plaintiff whole.

Historically, in construction defect cases, cost of repair of the defect and diminished property value generally were considered mutually exclusive remedies. Often, the applicable analysis hinged on economics. If the cost of remediation exceeded the value of the property, the difference in the value of the property before and after the defect was the measure of damages. If the property could be repaired and restored to its original state, then the repair costs were the proper measure of damages. This rationale still make sense, and most courts continue to follow this rule.

In contrast, the concept of stigma damage argues that some damage or loss survives remediation: when the cost of repair does not fully compensate plaintiffs, they should be compensated for their remaining loss, or they will be permanently deprived of significant value.

Much of the precedent for stigma damages comes from environmental cases and the common law concepts of nuisance and trespass. Stigma, as applied in those cases, although instructive, does not transfer to construction defect cases without thorough understanding of applicable concepts. Environmental cases generally deal with a permanent injury to the land, rather than a repairable injury to a structure. Further, because courts have often homogenized diminution and stigma in the traditional construction defect damage framework, there have been inconsistent results.

In one case, however, the California Supreme Court recognized a difference between “stigma damages” and “diminution in value.” In its decision in *Aas v. Superior Court of San Diego County*, 12 P.3d 1125 (Cal. 2000), the court explained the distinction, noting that while California law allows recovery of diminution, no reported decision appear to support stigma damages.

In a footnote, the court wrote, Plaintiffs did abandon a claim for so-called stigma damages, representing the residual loss of market value after repairs have been made, after losing on this issue in the Court of Appeal. As that court explained, no reported decision in this state appears to authorize such

recovery. In contrast [to stigma damages], diminished value is simply one of the standard alternative measures of damage for injury to property. The successful plaintiff in such cases ordinarily recovers either the diminution in market value attributable to the injury or the cost of repairs, whichever is less.

Id. at 1141.

The biggest misconception in these cases in the context of construction defects is that the stigma and diminution in value are the same.

Most commonly, a discussion of stigma damages reads as in the Florida Court of Appeals for the Fifth District decision in *Orkin Exterminating Co. v. DelGuidice*, 790 So. 2d 1158 (Fla. Dist. Ct. App. 2001). There, the court considered the claims of the owner of a home that experienced termite damage. After building his home, DelGuidice contracted with Orkin to provide termite protection, and the contract provided for the repair of termite damage and re-treatment to prevent or control a re-infestation of termites. Orkin was unsuccessful in preventing the termites from repeatedly infesting the home, and DelGuidice sued for breach of contract. At trial the jury awarded him either diminution in value or stigma damages of \$300,000. (The exact nature of the jury’s award is unclear from the opinion.)

The court wrote that diminution in value damages, or stigma damages not otherwise provided for in a contract, can be awarded in Florida on a breach-of-contract theory only under limited circumstances. The court held that diminution in value damages are appropriate when a repair or a replacement remedy is impracticable, but did so without referencing stigma damages in that opinion section. *Id.* at 1159. The court supported its holding by noting that the Florida Supreme Court has adopted Section 346(1)(a) of the

Restatement (First) of Contracts (1932) with respect to breach-of-construction contracts. The court highlighted a portion of the comment to that subsection: "Sometimes defects in a complete structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to

It is only the subjective belief in the stigma that creates it.

be measured by a method requiring such economic waste." *Id.* at 1160. This is the classic economic-efficiency rationale for diminution damages.

The court went on to articulate that if a plaintiff can be made whole by repair compensation, the law does not allow an additional windfall type of recovery for a diminution in value beyond the cost of repair. But, if the diminution in value is less than the cost of repair, diminution in value becomes the standard, because to repair under this circumstance amounted to economic waste. *Id.*

It is clear that the court articulated the well-settled concept of "economic waste" as the determining factor in awarding either repair costs or diminution in value, even if it made occasional reference to stigma damages. The court did not discuss whether Florida law allows true stigma damages recovery in the opinion.

Damnum Absque Injuria

The Latin phrase, *damnum absque injuria*, defined as "damage without injury," most accurately describes stigma damages. True stigma damage does not seek recovery for a physical injury to a property, which is straightforward: repair cost or diminution in value. As noted, when properly argued or analyzed, stigma damages represent a remedy distinct from diminution in value. Stigma damages are unique in that they are both the injury and the measure of damages. It is only the subjective belief in the stigma that creates it.

As mentioned, courts have much experience dealing with this idea in environmental claims, nuisance and trespass claims. Commonly it arises in situations involving uncontaminated property in which the property owner still maintains that the property is worth less due to stigma caused by a nearby contaminated property. In those cases, courts are unlikely to allow recovery. There is a long line of cases adopting this position.

For example, the Fourth Circuit affirmed a Rule 12(b)(6) dismissal of nuisance and negligence claims based on stigma damages. *Adams v. Star Enterprises*, 51 F.3d 417 (4th Cir. 1995). In *Adams*, a group of homeowners alleged that an underground oil spill caused by the defendant had caused toxic vapors to spread throughout the area, and that despite the defendant's remediation efforts, public fear of exposure remained. There had been no actual physical invasion of the plaintiffs' land. In fact, the plaintiffs did not even allege that any noxious odors were present on their land. In affirming the district court's dismissal of the complaint, the Fourth Circuit stated that the plaintiffs "alleged mere fear" of health risks, and that their claim that their property values had declined due to the stigma caused by the oil spill was too speculative to make a nuisance claim under Virginia law. *Id.* at 422. The court found no Virginia case had permitted recovery for a private nuisance that was not visible or otherwise physically detectable from the plaintiffs' property. *Id.* at 422-23. In dismissing the negligence action, the court applied the general rule that there is no recovery for economic harm absent physical impact. *Id.* at 423-25 (citing Restatement (Second) of Torts §766(c)).

Likewise, in *Berry v. Armstrong Rubber Co.*, 989 F.2d 822 (5th Cir. 1993), *cert. denied*, 510 U.S. 1117, 127 L. Ed. 2d 386, 114 S. Ct. 1067 (1994), property owners sued a former tire manufacturer, alleging that by dumping toxic wastes on its own property, Armstrong had harmed adjoining property. The district court granted summary judgment for the defendant. The Fifth Circuit affirmed, agreeing with the district court that even accepting the truth of the plaintiffs' expert's testimony that the stigma attached to their property had decreased its value, the "plaintiffs could not recover

under Mississippi law for reduced market value caused by a 'stigma' absent some physical damage to plaintiffs' land caused by the defendant." *Id.* at 829.

In *Adkins v. Thomas Solvent Co.*, 440 Mich. 293, 487 N.W.2d 715 (Mich. 1992), the plaintiff landowners sued a chemical company that operated a plant on adjacent property, asserting various claims based on the defendant's alleged contamination of groundwater. Experts on both sides agreed that the plaintiffs' own properties would never be polluted by groundwater, but the plaintiffs sought damages for diminution in value. The trial court granted summary judgment for the defendant. An appellate court reversed, but the Supreme Court of Michigan, in a 5-3 decision, reversed the appellate court. In a well-reasoned, thorough opinion, the majority said that "negative publicity resulting in unfounded fear about dangers in the vicinity of the property does not constitute a significant interference with the use and enjoyment of land." *Id.* at 306 (footnote omitted). The court added that "mere diminution of the value of property because of the use to which adjoining or nearby premises is devoted, if unaccompanied with other ill results, is *damnum absque injuria*—a loss without an injury, in the legal sense." *Id.* at 311 (quoting *Gunther v. E.I. Du Pont De Nemours & Co.*, 157 F. Supp. 25, 33 (N.D.W.Va. 1957), *app. dismissed*, 255 F.2d 710 (4th Cir. 1958)).

It is the majority position in the United States that without a physical injury stigma damages cannot be awarded. In *re Paoli R.R. Yard PCB Litigation*, 35 F.3d 717 (3d Cir. 1994), *cert. denied*, 513 U.S. 1190 (1995), sets out this principle very clearly. In *Paoli*, plaintiffs sued several defendants seeking damages resulting from exposure to PCBs. The Third Circuit reversed the district court's grant of summary judgment for the defendants on the plaintiffs' claim for the diminution in property value of their homes caused by the presence of PCBs on their land, making it clear that under Pennsylvania law stigma damages are not available absent at least some temporary physical damage to the property. The court held that

...where (1) defendants have caused some (temporary) physical damage to plaintiffs' property; (2) plaintiffs dem-

onstrate that repair of this damage will not restore the value of the property to its prior level; and (3) plaintiffs show that there is some ongoing risk to their land, plaintiffs can make out a claim for diminution of value of their property without showing permanent physical damage to the land.

Id. at 798 (footnote omitted).

Additionally, the court commented on whether the rule could lead to liability for unfounded fears outside the context of an environmental claim. The court opined that these concerns were overstated, because “the rule we have articulated only allows recovery when there has been some initial physical damage to plaintiffs’ land.” *Id.* at 798 n. 64.

In Ohio, the decision in *DeSario v. Industrial Excess Landfill Inc.*, 587 N.E.2d 454 (Ohio Ct. App. 1991) allowed stigma damages without a related showing of injury to the land. But in 2003, the Ohio Court of Appeals ruled that, absent a showing of “actual harm,” Ohio does not recognize as compensable “pure environmental stigma, defined as when the value of real property decreases due solely to public perception or fear of contamination from a neighboring property.” *Ramirez v. AKZO Nobel Coatings*, 791 N.E.2d 1031, 1034 (Ohio Ct. App. 2003) (holding that any precedential value of *DeSario* had been superseded by the Ohio Supreme Court’s subsequent decision in *Chance v. BP Chemicals Inc.*, 670 N.E.2d 985 (Ohio 1996)).

In a recent decision from the Supreme Court of Kansas, the court ruled that a property owner cannot collect damages under a negligence or nuisance theory for diminution in the property’s market value caused by stigma or market fear resulting from an accidental contamination, if the property owner has not proved either a physical injury to the property or physical interference with the owner’s use and enjoyment of the property. *Smith v. Kansas Gas Service Co.*, 169 P.3d 1052 (Kan. 2007)

The Kansas Supreme Court noted that no evidence established loss of market value based on physical injury to the real property or interference with the use and enjoyment of the property. Instead, the testimony about lost market value was based on a perceived stigma or fear among the buying public. The court acknowledged

that, although stigma damages are recognized in Kansas, they are recognized only in cases in which the property has sustained physical injury as a result of the defendant’s conduct. *Id.*, 169 P.3d at 1059.

Stigma Damages for Construction Defects

Several states have recognized stigma damages in construction defect cases. The cases tend to adhere to the rule discussed above that recovery for stigma damages must be accompanied by some actual harm to the property. The lack of a physical injury to property is likely to be rare in a construction defect case, but it is theoretically possible. Consider *Mayer v. Sto Industries, Inc.*, 156 Wn. 2d 677, 132 P.3d 115 (Wash. 2006). There, the Washington Supreme Court affirmed an award for stigma damages to the owner of a home sided with synthetic stucco, or EIFS. In its ruling the court explained that “where the damage to real property is permanent, a plaintiff is entitled to recover not only the costs of restoration or repair, but also for the property’s diminished value.” *Id.* at 124. It appeared important to the court that the trial court testimony included unrebutted expert testimony that the owners had suffered a permanent loss because they would have to disclose that the home was sided with EIFS, which the court called a “known defective product.” This language suggests that the court was persuaded to allow stigma damages because of the permanent nature of the harm caused by the continuing presence of the defective product. While the homeowners in *Mayer* did sustain other damage to their home, the EIFS was not repaired or replaced. Based on the court’s reasoning that the stigma damage was caused by the mere presence of a “known defective product,” it seems possible that a homeowner might cite this case in an argument for stigma damages without a corresponding physical injury.


New York recognizes that damages may be proper for a fair market value reduction of real property caused by fear of past construction defects, even after the defects are corrected. However, the court noted that market stigma damages recovery is permitted only if a plaintiff can demonstrate that repairing the damage will not restore the property to its original market value.

Farrell v. Lane Residential, 831 N.Y.S.2d 353 (N.Y. Supp. 2006), unreported disposition (citing *Putnam v. State of New York*, 223 A.D.2d 872, 636 N.Y.S.2d 473 (N.Y. App. Div. 1996)). In contrast to the holding in *Mayer*, the court here left no doubt that actual injury to the property was a predicate to the award of stigma damages.

Mississippi also allows recovery of stigma damages in the construction defect context. In *Harrison v. McMillan*, 828 So. 2d 756 (Miss. 2002), the Mississippi Supreme Court approved the use of an instruction to the jury that directed the jury to award reasonable costs of repairs if the repairs would restore the property to the reasonable market value before damage, but, if the repairs did not restore the property to its reasonable market value before the harm, the plaintiff was entitled to recover the reasonable cost of repair to the property, plus the difference between the reasonable market value of the property without the damage and the reasonable market value after all the repairs were made. In other words, the court recognized that the plaintiff was entitled to recover the loss of market value because the jury found that even with the repairs, the house did not achieve its fair market value.

More broadly, the Colorado Supreme Court recognized that the selection of an appropriate measure of damages is within the discretion of the trial court. The trial court must take as its principal guidance the goal of reimbursing a plaintiff for losses actually suffered. *Bd. of County Comm’rs v.*

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Slovak, 723 P.2d 1309 (Colo. 1986). While *Slovak* suggests that Colorado may allow stigma damages if repair or diminution in value damages cannot make a plaintiff whole, another Colorado case takes a more traditional position.

In *Gold Rush Investments, Inc. v. G.E. Johnson Construction Co.*, 807 P.2d 1169 (Colo. App. 1990), the court ruled that if

critical fact here may have been that the termite damage was present before the owners purchased the house. The court may have determined that had the report accurately reflected the termite damage, the owners may have negotiated a lower purchase price. But having relied on the erroneous report, they were damaged to the extent that what they paid for was not what they actually received.

California, as noted above, has no reported cases directly addressing stigma damages in construction defect cases. Dicta in the *Aas* decision suggests that the California Supreme Court was ready to apply the economic-loss rule to bar a tort-based recovery for the loss of market value as a purely economic loss. However, in response to *Aas*, the California Legislature enacted Civil Code §895 et. seq. (the Right to Repair Act), which established a set of building standards for new construction that provides homeowners with a cause of action against builders, contractors, product manufacturers and others for violating the standards. The act states that upon a showing of a violation, a homeowner may recover economic losses without having to show that the violation caused actual property damage or personal injury. See, *Greystone Homes, Inc. v. Court of Appeal of California*, 168 Cal. App. 4th 1194, 86 Cal. Rptr. 3d 196, 2008 Cal.App. LEXIS 2376 (Cal. Ct. App. 2008). Presumably, if the stigma grew from an articulated standard violation, the economic-loss rule defense would be abrogated by statute.

The Court of Appeals of Washington, Division One, may have described the analysis most eloquently in *Pugel v. Monheimer*, 83 Wn. App. 688, 922 P.2d 1377 (Wash. App. 1996). There the court stated,

We have said before that ‘damages are not precluded simply because they fail to fit some precise formula’ for measuring them. In making any compensatory award, the court should use a measure of damage that makes the injured party as whole as possible without conferring a windfall. Where the injury to property is permanent, the usual measure of damages is the difference between the value of the land before the injury and immediately after, where the injury is not permanent and the premises can be restored to their original condition, the

usual measure of damage is restoration costs and loss of use. These two distinct measures of damages are alternatives, an award of both would be a windfall. But *Pugel* did not attempt to establish the difference in the market value of his property before and after the injury. He established the loss of market value remaining after he had shored up the building and repaired the cracks. The trial court’s award of damages, in limiting *Pugel* to this remaining loss of value while omitting his out-of-pocket repair expenses altogether, did not make him whole. He is entitled to an award that combines the two.

Id. at 1379 (footnotes omitted).

Conclusion

Although they are often confused with diminution in value damages, if they are correctly pled, with some evidence of tangible physical injury, courts will likely allow triers of fact to consider stigma damages. Are stigma damages real? I think the answer is, they are if you believe that they are. As I can personally attest, even though I rationally knew that the house that my wife and I considered had been repaired, I was still reluctant to buy someone else’s problem. My own experience suggests that people recognize that even when some types of defects are repaired, some damage remains. And now, with all the publicity about the Chinese drywall, it is likely that stigma damage claims will result, and it is just as likely that they will continue to evolve.

The key to defending against stigma damage claims is to understand the distinction between stigma and diminution in value. A familiarity with your jurisdiction’s decisions in environmental cases, specifically nuisance and trespass, can greatly help, if you find no construction-based decisions.

Lastly, although it is beyond the scope of this article, many issues arise with the proof required to sustain stigma claims. It is doubtful that sufficient evidence could be established without the use of a real estate appraiser, whose work is necessarily governed by the Uniform Standards of Professional Appraisal Practice (USPAP). Determining the value of stigma damage is a highly complicated and uncertain exercise.

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physical reconstruction would involve unreasonable economic waste by destroying usable property or take some other wasteful form, damages should be measured by reduction in market value. *Id.* at 1174. While this decision tracks the historical choice between repair and diminution, there is nothing in the opinion which precludes stigma outright. Assuming proof that a feasible and economic repair could be made, but the repair would not return the property to its pre-injury market value, the *Slovak* decision provides support for such damages.

In *Horsch v. Terminix Int’l Co.*, 19 Kan. App. 2d 134, 865 P.2d 1044 (Kan. Ct. App. 1993), *rev. denied*, 254 Kan. 1007 (1994), plaintiffs had purchased a house relying in part upon a termite inspection report indicating that the house had no evidence of termite damage. Subsequently, the plaintiffs discovered termite damage. They sued for the cost of remediation and the reduction in the value of the home due to the stigma of a termite infestation. The court held that “Under the facts of this case, where a buyer purchased a house in reliance on a termite company’s report that incorrectly stated the house had no prior termite damage, the company may be liable both for the cost of repair of the damage and any reduction in market value of the house caused by marketplace fear of houses with prior termite damage.” *Id.* The