An Overview of Property Insurance Appraisal

"Resolution of Property Insurance Claims in the Modern Age – Appraisal, Mediation and Arbitration"

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Tim Gray is the Director of Claims with Argo Insurance in the Portland, OR office. Tim started his insurance career in 1992 working for American National. After taking some time off to start of a prosperous Gymnastics Academy with his spouse back in 1995, he began working for Argo Insurance (Grocers Insurance at this time) in 1997. Tim was promoted from adjuster to manager in 2003 when the first dedicated Property Team for Argo Insurance was set up. Since 2003, Tim has put in place the standards and philosophies for the handling of Property Claims for Argo Insurance. Tim's unit handles the property claims for all US Argo Group units; Argo Insurance, Trident Insurance, and Colony Insurance. Each unit has a special market focus that brings in a wide variety of claims from admitted and non-admitted policies throughout the country. Tim has substantial experience in having claims resolved through the appraisal process in States across the country. Tim's claim background is rich with variety and complexity in the commercial claims field.

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An Overview of Property Insurance Appraisal

Appraisal has long been used as a tool to resolve disputes concerning the amount of an insured loss. In the past, appraisal was generally limited to quantification – a determination of how much it cost to repair damage. Parties and courts recognized that appraisal was not an appropriate method to determine questions of causation, coverage, or liability. Appraisal was typically only invoked if the carrier and insured agreed on the existence and scope of covered damage, but disagreed on the cost to repair such damage. Disagreements regarding the existence of damage, the scope of damage, and when the damage may have occurred historically fell outside the appraisal process – conventional alternative dispute resolution or litigation were the parties' only vehicles to resolve such issues. More recently, however, the scope of appraisal has broadened, and it is being used to resolve claim disputes that go beyond mere disagreements about the value of covered damage.

For example, appraisal is often invoked in the context of disputes concerning hail damage to roofs. The policyholder seeks full replacement of a 30-year-old roof due to covered hail damage; the insurer denies the roof requires complete replacement as a result of hail damage and argues much of the roof has deteriorated due to excluded wear and tear. To resolve the dispute and avoid litigation, appraisal is now often invoked to determine the "amount of loss," which may involve a determination of causation under these facts. The invocation of appraisal at this point of time in the adjustment process was, in the past, premature since the parties had not yet agreed to causation or coverage. However, the trend toward expansion of the scope of appraisal now often makes these issues fair game for resolution in the appraisal process.

This paper provides a general overview of appraisal under a property insurance policy and addresses the benefits, pitfalls, and recent trends in the use of appraisal to resolve disputed property insurance claims. It also provides some practical advice in navigating the appraisal process in light of its expanding scope.

A. What is appraisal?

Appraisal grew from the recognition among property insurers and their insureds that not every insurance dispute necessitated the expense and headache of a full-blown lawsuit. Accordingly, most property insurance policies contain an appraisal provision as a means of alternative dispute resolution. Many states also require appraisal by statute (*i.e.* the form policies approved for issuance in those states contain appraisal provisions). But what is it? And is it an effective dispute resolution tool?

Although the language of an appraisal provision varies from policy to policy, a typical one states:

> If we and you disagree on the value of the property or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser. The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the value of the property and the amount of the loss. If they fail to

> agree, they will submit their differences to the umpire. A decision agreed by any two will be binding.
>
> Each party will:
>
> a. Pay its chosen appraiser; and
>
> b. Bear the other expenses of the appraisal and umpire equally.
>
> If there is an appraisal, we still retain our right to deny the claim.[1]

Appraisal therefore contemplates: (1) a disagreement concerning the amount of loss; (2) a written demand for appraisal; (3) the selection of two competent impartial appraisers (one for the insured and one for the insurer); (4) the appraisers' mutual selection of an umpire or, if one cannot be agreed upon, selection of an umpire by a court having jurisdiction; (5) the appraisers working together to agree on the amount of loss; (6) submittal of any disagreements concerning the amount of loss to the umpire; and (7) a binding decision by the two appraisers or one appraiser and the umpire.

Although most appraisal provisions contain the same or similar language, they are applied differently from one jurisdiction to another. Therefore, it is always important to evaluate such provisions under the controlling law of the applicable jurisdiction.

1. Appraisal v. Arbitration – What is the Difference?

Because both are methods of alternative dispute resolution available in the insurance context, appraisal is often compared to (and sometimes confused with) arbitration. While they share common features, including the avoidance of full-blown litigation, most authorities agree there are significant differences between them. Not all jurisdictions, however, have taken this view. In several states, appraisal is regarded as a form of arbitration. Even in states that have recognized some distinction between the two processes, courts sometimes use the terms "appraisal" and "arbitration" interchangeably, creating an element of uncertainty and confusion.

While there are many definitions of the term "appraisal," the common denominator among them is the concept of valuation:

> **Appraisal,** *n.* (1817) **1.** The determination of what constitutes a fair price; valuation; estimation of worth. **2.** The report of such a determination. – Also termed *appraisement.* Cf. ASSESSMENT (3). – **appraise,** *vb.*[2]

As one court noted, "appraisal is primarily concerned with ascertaining the value of something."[3] In the insurance context, appraisal is used to ascertain the value of a property loss.

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1 ISO Building and Personal Property Coverage Form CP 00 10 04 02.

2 BLACK'S LAW DICTIONARY 117 (9th ed. 2009).

3 *FTI Int'l, Inc. v. Cincinnati Ins. Co.*, 339 Ill. App. 3d 258, 260 (Ill. Ct. App. 2003).

The primary characteristic that differentiates appraisal from arbitration is coverage evaluation, although even this difference has eroded in some jurisdictions as the scope of appraisal has expanded. As one leading insurance treatise observed, "appraisal is distinguished by its more limited role."[4] Whereas appraisers are focused on determining the amount of the loss or damage, reserving coverage issues for a court's determination, arbitrators' duties are broader in that they are often charged with resolving the entirety of the dispute between the parties:

> In the insurance context, appraisal is most often used to determine the amount of the loss sustained under a property insurance policy. Arbitration is a more far-reaching proceeding, by which the parties agree to have a neutral person or persons resolve a disputed matter.[5]

New York courts, among others, have distinguished appraisal from arbitration on this basis.[6] Further, some jurisdictions, which prohibit the arbitration of insurance disputes, have enforced appraisal provisions because their more limited scope has been found to preserve the court's jurisdiction by permitting litigants to later test the award. Louisiana's highest court has adopted this view.[7]

Another difference between arbitrations and appraisals is that appraisers do not always share the "quasi-judicial" quality typical of arbitrators:

> [A]ppraisers are generally expected to act on their own skill and knowledge. They may reach individual conclusions and are required to meet only for the purpose of ironing out differences in the conclusions reached, and they are not obliged to give the rival claimants any formal notice or to hear evidence, but may proceed by ex parte investigation so long as the parties are given opportunity to make statements and explanations with regard to matters in issue. Arbitrators, on the other hand, must meet together at all hearings. They act quasi-judicially and may receive the evidence or views of a party to the dispute only in the presence, or on notice to, the other side, and may adjudge the matters to be

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[4] 15 COUCH ON INSURANCE 3d §209:8 (2005); *see also Merrimack Mut. Fire Ins. Co. v. Batts*, 59 S.W.3d 142, 149 (Tenn. Ct. App. 2001) ("Appraisal is something narrower. Appraisal is the act of estimating or evaluating something; it usually means the placing of a value on property by some authorized person.")

[5] 15 COUCH ON INSURANCE 3d at § 209:4.

[6] *Kawa v. Nationwide Mut. Fire Ins. Co.*, 174 Misc. 2d 407, 664 N.Y.S.2d 430, 431-32 (N.Y. Sup. Ct. 1997) (citing *In re Delmar Box Co., Inc.*, 309 N.Y. 60, 127 N.E.2d 808 (1955)) ("[A]rbitration . . . ordinarily encompasses the disposition of the entire controversy while appraisal extends merely to specific issues of cash value and the amount of loss, leaving all other issues for determination in a plenary action"); *see also In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193, 195 (Tex. 2002) ("while arbitration determines the rights and liabilities of the parties, appraisal merely 'binds the parties to have the extent or amount of the loss determined in a particular way'"); *Cas. Indem. Exch. v. Yother*, 439 So.2d 77, 79-80 (Ala. 1983) (distinguishing between arbitration and appraisal but declining to determine which type of provision was at issue in that case).

[7] *Sevier v. U.S.F.& G*, 485 So.2d 132, 136 (La. App. 2 Cir. 1986), *rev'd on other grounds*, 49 So.2d 1380 (La. 1986) ("We agree that mandatory *arbitration* vests the arbiter with the decision making power. However, *appraisal*, by definition, enables the court to inquire into the circumstances surrounding appraisal.")

decided only on what is presented to them in the course of an adversary proceeding.[8]

Courts in several states have focused on the quasi-judicial nature of arbitrations to distinguish them from appraisal proceedings.[9] For example, in Florida, courts have looked to the level of formality of the proceeding called for by an appraisal provision to determine whether appraisal or arbitration was intended by the parties and whether state arbitration statutes govern a proceeding.[10] Interpreting an appraisal clause in *Allstate Insurance Co. v. Suarez*, Florida's highest court observed that "[i]t is clear from a plain reading of the clause that an informal appraisal proceeding, *not* a formal arbitration hearing" pursuant to a Florida arbitration statute was agreed upon by the parties.[11] The court concluded that once a trial court determines that an appraisal clause has been invoked, subsequent proceedings cannot be conducted as arbitrations.[12]

It should be noted, however, that while many appraisals are less formal and do not resemble full-blown adversary proceedings, some may take on the quasi-judicial characteristics of an arbitration – particularly those involving large losses. A federal court sitting in New York recently declined to vacate an appraisal award despite the insured's argument that the proceeding had "morphed into an arbitration" as it involved the submission of thousands of pages of documents, the taking of seven witnesses' testimony, and legal briefing.[13] The award was confirmed on the grounds that the panel had stayed within the scope of its assignment to resolve "factual disputes over the amount of loss."[14]

Thus, while many jurisdictions have specifically concluded that appraisals do not constitute arbitration proceedings,[15] other states have obfuscated – or even eradicated – the distinction between them. As one commentator noted, the failure of the Arizona courts and legislature to address the distinctions between appraisal and arbitration in that state threatens to undermine a key goal of appraisal: the resolution of disputes without resort to litigation.[16]

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8 4 AM. JUR. 2D *Alternative Dispute Resolution* §3 (2010).

9 *See, e.g., IP Timberlands Op. Co., Ltd. v. Denmiss Corp.*, 726 So.2d 96, 105 (Miss. 1998) ("[A]rbitration presupposes the existence of a dispute or controversy to be tried and determined in a quasi-judicial manner, whereas appraisement is an agreed method of ascertaining value or amount of damage.").

10 *Allstate Ins. Co. v. Suarez*, 833 So.2d 762, 765 (Fla. 2002).

11 *Id.*

12 *Id.*

13 *Amerex Group, Inc. Lexington Ins. Co.*, 07 Civ. 3259 (HB), 2010 U.S. Dist. LEXIS 102098, at *7-9 (S.D.N.Y. Sept. 28, 2010).

14 *Id.* at *8-9.

15 *Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1062 (5th Cir. 1990) ("Under Texas law it is clear that an insurance appraisal which only determines the value of a loss is not an arbitration."); *Tamko Bldg. Prods., Inc. v. Factory Mut. Ins. Co.*, Case No. 4:09CV1401 CDP, 2009 U.S. Dist. LEXIS 121320, at *4-5 (E.D. Mo. Dec. 30, 2009) ("Traditionally, Missouri courts have distinguished arbitration and appraisal"); *Sun Microsystems, Inc. v. Electronic Servs. Inc.*, 25 Mass. L. Rep. 341, 2009 Mass. Super. LEXIS 95, at *11 (Mass. Super. Ct. Apr. 13, 2009) (concluding that appraisal provision did not constitute "arbitration" within the meaning of a state arbitration statute).

16 *See generally* Amy M. Coughenour, *Comment: Appraisal and the Property Insurance Appraisal Clause – A Critical Analysis: Guidance and Recommendations for Arizona*, 41 ARIZ. ST. L.J. 403 (2009).

Still other states have determined that appraisals are a species of arbitration.[17] In Connecticut, for instance, it is well-established that appraisal provisions constitute agreements to arbitrate that are within the ambit of state arbitration statutes.[18]

A significant consequence of the manner in which a particular jurisdiction treats appraisal is the potential determination of which body or bodies of statutory law govern the proceeding. For instance, to the extent a given jurisdiction views appraisal as a form of arbitration, certain state and/or federal arbitration statutes may be found to apply. Notably, there are several states, including some that have adopted the Uniform Arbitration Act, that apply state arbitration statutes to appraisal proceedings.[19] Other jurisdictions have expressly rejected this position.[20] Further, while some states appear to acknowledge differences between appraisal and arbitration, they nevertheless apply at least some statutory arbitration standards to appraisal.[21]

2. Overview of State Laws Addressing Appraisal

In some jurisdictions, appraisal provisions are required by statute. In these jurisdictions, the legislatures have either included the appraisal provision in the standard form policy approved for use in the state or enacted statutes specifically requiring their inclusion in certain types of policies.

The following states require inclusion of an appraisal provision in the standard form insurance policy: California,[22] Connecticut,[23] Iowa,[24] Louisiana,[25] Maine,[26] Michigan,[27] Minnesota,[28] New Hampshire,[29] New Jersey,[30] New York,[31] North Carolina,[32] Oklahoma,[33] Pennsylvania,[34] Rhode Island,[35] and Virginia.[36]

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[17] *E.g.*, *Friday v. Trinity Universal of Kansas*, 939 P.2d 869, 871 (Kan. 1997) (holding that appraisal provision constituted an unenforceable arbitration provision under state law and observing that "[w]e do not see a meaningful distinction between appraisal and arbitration").

[18] *Giulietti v. Connecticut Ins. Placement Facility*, 534 A.2d 213, 217 (Conn. 1987); *see also Covenant Ins. Co. v. Banks*, 177 Conn. 273, 279-80 (1979) (minimizing any distinction between appraisal and arbitration and holding that state arbitration statutes apply to appraisal proceedings).

[19] *See Tamko Bldg. Prods., Inc. v. Factory Mut. Ins. Co.*, Case No. 4:09CV1401 CDP, 2009 U.S. Dist. LEXIS 121320, at *6 n.2 (E.D. Mo. Dec. 30, 2009) (citing cases).

[20] *Tamko*, 2009 U.S. Dist. LEXIS 121320, at *6 (holding that appraisal provision was not subject to Missouri's Arbitration Act and that the Act did not, therefore, bar the enforcement of the appraisal provision); *Rastelli Bros., Inc. v. Netherlands Ins. Co.*, 68 F. Supp. 2d 440, 446 (D.N.J. 1999) (holding that appraisals are not within New Jersey's Arbitration Act such that the Court must order that an appraisal proceed); *Suarez*, 833 So.2d 762, 765 (holding that the Florida Arbitration code was not applicable to appraisal proceedings).

[21] *See Quade v. Secura Ins.*, 792 N.W.2d 478, 483 (Minn. Ct. App. 2011) (dicta).

[22] Cal. Ins. Code § 2071.

[23] C.G.S.A. § 38a-307.

[24] I.C.A. § 515.109.

[25] LSA-R.S. § 22:1311.

[26] M.R.S.A. § 3002.

[27] M.C.L.A. § 500.2833.

[28] M.S.A. § 65A.01.

[29] N.H. Rev. Stat. § 407:22.

Some states' statutes require the inclusion of appraisal clauses in certain *types* of policies. For example in Alaska, Massachusetts, and North Carolina, the statutes require that automobile policies include an appraisal provision.[37] Alaska also requires the inclusion of appraisal clauses in property policies, as does Oregon.[38] Finally, Maine, North Carolina, South Carolina, and Wisconsin require that policies insuring public or state-owned property include an appraisal provision.[39]

However, even if such provisions are not required by statute, property insurance policies often include appraisal provisions. Whether required by statute or included by agreement, the appraisal provision is typically worded very similarly and thus often the same legal issues are relevant.

B. <u>Legal Issues Regarding Appraisal</u>

While there are typically only modest variations among appraisal provisions found in modern property insurance policies, there are significant jurisdictional variations in the way such provisions are enforced and construed. Some jurisdictions lack a well-developed body of case law addressing questions relating to appraisal, but others have been confronted often with fundamental questions regarding its nature, scope, and purpose. The decisions arising out of these cases have, in some instances, clarified the law of appraisal and provided needed guidance to parties seeking to use this important contractual right to resolve loss measurement disputes. Others have merely confused the issues concerning appraisal's proper scope and its ultimate value as an efficient dispute resolution tool. The following discussion will provide an overview of the most common appraisal issues being addressed by courts.

1. Scope of Appraisal: Amount of Loss v. Causation

In recent years, courts in various jurisdictions have grappled with difficult questions regarding the appropriate scope of appraisal. Specifically, courts have been tasked with determining where an appraisal panel's work ends and where the function of the courts begins. While some jurisdictions limit the role of the appraisers to determining only the dollar value of the claimed loss, others have taken a more pragmatic view, allowing additional issues to be decided by appraisal panels.

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30 N.J.S.A. § 17:36-5.20.

31 McKinney's Ins. Law § 3404.

32 N.C.G.S.A. § 58-44-16.

33 36 Okla.St.Ann. § 4803.

34 40 P.S. § 636.

35 R.I. Gen. Laws § 27-5-3.

36 VA Code Ann. § 38.2-2105.

37 AS § 21.96.035; M.G.L.A. 175 § 191A; N.C.G.S.A. § 20-279.21.

38 AS § 21.96.035; O.R.S. 742.232.

39 M.R.S.A. § 1728-A; N.C.G.S.A. § 115C-541; SC Code § 10-7-180; W.S.A. § 605.23.

There is general agreement that the role of an appraisal panel is to determine the "amount of loss," while coverage determinations are appropriately reserved to the courts for resolution.[40] As the U.S. Court of Appeals for the Second Circuit observed:

> It is well established that the scope of coverage provided by an insurance policy is a purely legal issue that cannot be determined by an appraisal, which is limited to factual disputes over the amount of loss for which an insurer is liable.[41]

However, the line between determining the "amount of loss" or damage and resolving questions of coverage is not as clear-cut in reality. Straightforward loss determinations devoid of any complicating considerations are the exception rather than the rule. Often, the matters requiring resolution are complex and nuanced, and can include, among other things, multiple types of damage and/or the potential that multiple causes were involved in the loss. It is these types of situations that have forced courts to examine the parameters of an appraisal panel's role.

A major issue that has been the subject of several recent decisions is the extent to which an appraisal panel may consider loss causation in rendering a determination as to the amount of loss or damage. While courts have come down on both sides of this question, the balance seems to have swung in favor of allowing appraisers at least some discretion to consider causation. At the root of the causation question is whether causation is fundamentally an issue of liability (coverage) or damages in a particular case. As one court has observed, "[c]ausation relates to both liability and damages because it is the connection between them."[42]

a. Jurisdictions Limiting the Scope of Appraisal to Only "Amount of Loss"

Courts in several jurisdictions have attempted to draw rigid boundaries between the realm of appraisers (*i.e.*, damages) and the realm of the courts (*i.e.*, coverage) by disallowing any consideration of causation by appraisers. These courts have adopted a limited construction of the appraisers' obligation to determine the "amount of loss," holding that an appraiser's function is simply to render a value for the claimed loss.

Some courts have relied on the language of the appraisal provision itself – specifically, the term "amount of loss" – to determine and define the scope of the appraiser's task.[43] For example, Alabama's highest court relied heavily upon this term, and found it to be unambiguous, in

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[40] *E.g., HHC Assocs. v. Assurance Co. of Am.*, 256 F. Supp. 2d 505, 511 (E.D. Va. 2003) (holding that "whether coverage was properly denied is a legal issue reserved for the court alone"); *Florida Ins. Guar. Ass'n, Inc. v. Olympus Ass'n, Inc.*, 34 So.3d 791, 794 (Fla. Dist. Ct. App. 2010) ("Issues relating to coverage challenges are questions exclusively for the judiciary.")

[41] *Duane Reade Inc. v. St. Paul Fire & Mar. Ins. Co.*, 411 F.3d 384, 389 (2d Cir. 2005); *see also Kawa v. Nationwide Mut. Fire Ins. Co.*, 664 N.Y.S.2d 430, 431 (N.Y. Sup. Ct. 1997) (holding that appraisal was inappropriate where the insurer contested liability for a windstorm loss).

[42] *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009).

[43] *Caribbean I Owners' Ass'n, Inc. v. Great Am. Ins. Co. of New York,* 619 F. Supp. 2d 1178, 1186-88 (S.D. Ala. 2008); *Wausau Ins. Co. v. Herbert Halperin Distrib. Corp.*, 664 F. Supp. 987, 988-89 (D. Md. 1987); *Rogers v. State Farm Fire & Cas. Co.*, 984 So.2d 382, 392 (Ala. 2007); *Merrimack Mut. Fire Ins. Co. v. Batts*, 59 S.W.3d 142, 149 (Tenn. Ct. App. 2001); *see Jefferson Ins. Co. v. Superior Court of Alameda Cnty.*, 3 Cal. 3d 398, (Cal. 1970) (interpreting term "actual cash value").

holding that "appraisers are not vested with the authority to decide questions of coverage and liability."[44] Defining "amount of loss" as the monetary value of the property damage, the court held that appraisal was inappropriate where the parties did not agree on the cause of damage to the insured property's brick veneer or foundation (which the insurer claimed was caused by excluded earth settlement), even though the parties agreed that the roof of the insured property sustained covered tornado damage.

Similarly, federal courts construing Mississippi law have reaffirmed that state's long-standing position that "the purpose of an appraisal is not to determine the cause of loss or coverage under an insurance policy; rather, it is 'limited to the function of determining the money value of the property' at issue."[45] These cases go so far as to suggest that a resolution of coverage issues is a prerequisite to appraisal in Mississippi: "This Court 'must first determine the Policy's coverage of the losses and [the insurer's] liability for those losses, before the matter can be submitted for appraisal of the value of those losses.'"[46]

California courts have also held that appraisal panels cannot make causation determinations. In fact, in 2012, the California Court of Appeal issued two decisions that confirm the relatively limited scope of appraisal in that state. In *Doan v. State Farm Gen. Ins. Co.*, the insured alleged that the carrier improperly valued property lost in a fire by overstating its depreciation. The trial court dismissed the complaint, holding that the insured was required to submit his valuation dispute to appraisal, but the Court of Appeal reversed. The court emphasized the "limited powers" of insurance appraisers, and concluded that the complaint presented interpretation issues beyond the jurisdiction of an appraisal panel, because the policyholder was requesting a declaration as to whether the insurer's method of calculating depreciation was consistent with the applicable statute and regulations – a claim not subject to appraisal. The court thus concluded that the insured could seek a judicial declaration of his rights under the statute and policy before submitting to the appraisal process.

The *Doan* court relied heavily on another case decided earlier that year, *Kirkwood v. California State Auto. Ass'n Inter-Ins. Bureau*.[47] In *Kirkwood*, the Court of Appeal held that the trial court had the authority to defer an appraisal until after the resolution of the insured's claim for declaratory relief, which challenged the insurer's use of standardized schedules to determine depreciation of damaged property as contrary to California law and the parties' contract. The court concluded that those statutory and contract interpretation issues were outside the appraisers' authority, noting that an appraiser "has authority to determine only a question of fact, namely the actual cash value or amount of loss of a given item," and that an appraisal panel

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44 *Rogers*, 984 So.2d at 392.

45 *Jefferson Davis County Sch. Dist. v. RSUI Indem. Co.*, Civ. Action No. 2:08-cv-190-KS-MTP, 2009 U.S. Dist. LEXIS 16337, at *6 (S.D. Miss. Feb. 11, 2009) (quoting *Munn v. Nat'l Fire Ins. Co.*, 237 Miss. 641 (1959)); *Pearl River County Sch. Dist. v. RSUI Indem. Co.*, Civ. No. 1:08CV364HSO-JMR, 2009 U.S. Dist. LEXIS 80374, at *3-4 (S.D. Miss. Aug. 17, 2009); *see also Wells v. Am. States Preferred Ins. Co.*, 919 S.W.2d 679, 685 (Tex. Ct. App. 1996).

46 *Pearl River County Sch. Dist.*, 2009 U.S. Dist. LEXIS 80374, at *4; *Jefferson Davis County Sch. Dist.*, 2009 U.S. Dist. LEXIS 16337, at *7-8.

47 *Kirkwood v. California State Auto. Assn. Inter-Ins. Bureau*, 193 Cal. App. 4th 49, 122 Cal. Rptr. 3d 480 (Cal. App. 2011)

"exceeds its authority when it does anything beyond deciding the worth of the property in question."[48]

The *Kirkwood* court, moreover, distinguished and rejected the reasoning of three federal district courts in California, which it described as allowing appraisers to consider issues involving contract and statutory interpretation. One of those cases, *Enger v. Allstate Ins. Co.*,[49] raised claims similar to those in *Doan* and *Kirkwood* and was affirmed by the Ninth Circuit Court of Appeals in December 2010. In an unpublished opinion, the Ninth Circuit held an appraisal was required to determine the value of the insured's lost property, even if the parties' disagreement arose from the insurer's alleged use of an improper valuation method.

In light of *Kirkwood*'s express disapproval of *Enger*, California courts may now follow the more limited approach to appraisers' authority adopted by the state appellate court. Notably, however, in *De La Torre v. Allstate Ins. Co.*,[50] an opinion issued a few days after *Kirkwood*, the district court for the Central District of California sent to appraisal a dispute involving allegations that the insurer breached the policy by not including shipping charges in the actual cash value of the loss. The court concluded that the case presented a question of valuation of the items of property lost, which had to be resolved by the appraisers.

b. Jurisdictions Expanding the Scope of the Appraisal Clause by Holding that Causation Issues may be Determined by the Appraisal Panel.

While several jurisdictions circumscribe the role of appraisers, others find that considerations of causation are appropriate in an appraiser's determination of the "amount of loss," recognizing that lines between liability and damages are not so neatly drawn.[51]

In several recent decisions, courts reasoned that considering causation – at least to some extent – is actually a necessary component of an appraiser's task. For example, in *State Farm Lloyds v. Johnson*,[52] the Texas Supreme Court observed that "[c]ausation relates to both liability and damages because it is the connection between them" and that appraisers must always consider causation, at least as an initial matter:

> Any appraisal necessarily includes some causation element, because setting the "amount of loss" requires appraisers to decide between damages for which

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[48] *Id.*

[49] *Enger v. Allstate Ins. Co.*, 407 F. App'x 191 (9th Cir. 2010).

[50] *De La Torre v. Allstate Ins. Co.*, CV 10-08329 DDP PLAX, 2011 WL 836426 (C.D. Cal. Mar. 3, 2011).

[51] *E.g., Secord v. Chartis Inc.*, 09 Civ. 9934 (SAS) (FM), 2010 U.S. Dist. LEXIS 139852, at *41 (S.D.N.Y. Dec. 8, 2010) (concluding that it is "clear under Connecticut law that appraisers may consider scope and causation in calculating the amount of a loss"); *CIGNA Ins. Co. v. Didimoi Prop. Holdings, N.V.*, 110 F. Supp. 2d 259, 268 (D. Del. 2000) ("[T]he court believes that under the circumstances of this case, including the plain language of the policy, a determination of amount of loss under the appraisal clause includes a determination of causation."); *North Carolina Farm Bureau Mut. Ins. Co., Inc. v. Sadler*, 693 S.E.2d 266, 269 (N.C. 2010), discretionary appeal allowed, 2011 N.C. LEXIS 30 (N.C. Feb. 3, 2011) ("It would be impractical for an appraiser to make a value determination for potentially insured damages without acknowledging the cause."); *see Augenstein v. Ins. Co. of N. Am.*, 360 N.E.2d 320 (Mass. 1977).

[52] 290 S.W.3d 886 (Tex. 2009).

> coverage is claimed from damages caused by everything else . . . But whether the appraisers have gone beyond the damage questions entrusted to them will depend on the nature of the damage, the possible causes, the parties' dispute, and the structure of the appraisal award . . .[53]

In *Johnson*, an insurer argued that appraisal was not appropriate in connection with a dispute regarding hail damage to a homeowner's roof because the parties' dispute concerned causation and not the "amount of loss."[54] While the insurer's inspector concluded that hail had damaged only the ridgeline of the roof, the insured's inspector concluded that the entire roof required replacement. Although the court questioned whether the dispute was related to causation in the first instance (as there was no dispute that the damage in question was caused by hail), it determined that the insurer could not avoid appraisal merely because there might be a causation question.[55]

The *Johnson* court recognized that the facts of a given case determine which category "causation" generally falls into: "liability" or "damages." For instance, when different causes are alleged for a single injury to property, causation is a liability question for the courts.[56] However, "when different types of damages occur to different items of property, appraisers may have to decide the damage caused by each before the courts can decide liability."[57] Further, under *Johnson*, it is always the job of appraisers to separate loss due to a covered event from a property's pre-existing condition.[58]

Since *Johnson*, appraisals in Texas have expanded exponentially to involve determinations by the appraisers and umpire of whether damage was caused by a covered or a non-covered peril, as well as various other disputes traditionally considered to be coverage questions outside the purview of the appraisal provision.[59]

Louisiana courts have also expanded the scope of appraisal. In a recent decision involving a Hurricane Katrina loss, a federal court applying Louisiana law observed that, while "an appraiser's job is not to determine policy coverage or liability," causation must be considered in order to determine the scope of the loss that must be measured.[60] In that case, the court declined to set aside an appraisal award challenged by the insurer on the grounds that the appraisers made improper coverage determinations.[61] The court reasoned there was no Louisiana authority

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53 *Id.* at 892, 893.

54 *Id.* at 888.

55 *Id.* at 893.

56 *Id.* at 892. It is on this basis that the *Johnson* court distinguished a Texas appellate court's decision in *Wells v. American States Preferred Insurance Co.*, 919 S.W.2d 679, 685 (Tex. Ct. App. 1996), in which the appraisers assessed foundation damage due to plumbing leaks (a covered peril) as "0" but damage due to settling (an excluded peril) as $22,875.94. *Id.*

57 *Id.*

58 *Id.* at 892-93.

59 *TTM Investments, Ltd. v. Ohio Cas. Ins Co.*, 730 F.3d 466, 475 (5th Cir. 2013); *MLCSV10 v. Stateside Enters., Inc.*, 866 F. Supp.2d 691 (S.D. Tex. 2012).

60 *St. Charles Parish Hosp. Serv. Dist. No. 1 v. United Fire & Cas. Co.*, 681 F. Supp. 2d 748, 757 (E.D. La. 2010).

61 *Id.*

supporting the proposition that appraisers may not make causation determinations, and even if there were, "[a]ny decisions of causation contained in the award may still be challenged, and neither [the insurer] nor the Court is bound by them."[62]

Similarly, Florida has taken the position that causation is a question for the court in some circumstances, and for an appraisal panel in others. In *Johnson v. Nationwide Mutual Insurance Co.*,[63] Florida's highest court held that where an insurer contends there is no covered loss, causation is an issue to be determined by the court. The court further concluded that causation issues are appropriately submitted to an appraisal where an insurer admits there is at least some covered loss, but a disagreement exists as to the amount of the loss.[64] Thus, where the insured contends its entire loss is caused by a sinkhole (a covered peril) and the insurer contends the entire loss is caused by earth movement (an excluded cause), appraisal was rejected as improper.[65]

In 2012, Minnesota's highest court also entered the fray, taking an expansive view of the scope of appraisal. In *Quade v. Secura Ins. Co.*, the Minnesota Supreme Court ultimately determined an appraisal could go forward even though an insurer denied coverage for roof damage it concluded resulted from "continual deterioration over a period of time rather than a specific storm occurrence."[66] Noting that "the line between liability and damage questions is not always clear," the court reasoned:

> The [insureds] assert that the damage to the roofs is a covered loss for wind damage. [The insurer] asserts that the damage to the roofs is due to wear and tear and is excluded under the policy. We believe that under the circumstances of this case a determination of the "amount of loss" under the appraisal clause *necessarily includes a determination of causation*. . . .The [insureds] are incorrect that appraisers can never allocate damages between covered and excluded perils.[67]

The proper scope of appraisal continues to be an issue of great importance to parties, but there also continues to be great variance among jurisdictions. The practitioner should thus be cognizant of the law in the jurisdiction in which the claim arises (and any other state's laws may be applicable) before determining whether appraisal is appropriate under the facts of a given loss.

c. *Practical Guidance Concerning Scope of Appraisal*

When an insured and insurer find they cannot agree on the valuation of the loss and may consider appraisal as a tool to resolve the dispute, the advice of counsel well-versed in the

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[62] *Id.*

[63] 828 So.2d 1021, 1025 (Fla. 2002).

[64] *Id.*

[65] *Id.*

[66] *Quade v. Secura Ins.*, 814 N.W.2d 703, 704 (Minn. 2012).

[67] *Id.* at 706–07.

appraisal process can be of assistance. Experienced counsel know the pitfalls associated with appraisal and can aid in defining its appropriate parameters – especially when one party seeks to expand the scope of appraisal into areas that should be reserved for courts.

Next, parties and their counsel should be vigilant as the appraisal process proceeds to ensure the appraisal panel does not overstep its bounds. Often parties will select their respective appraisers, rely on them to identify the disputes and set the parameters for the appraisal, and simply await the outcome. But if the parties and their counsel pay attention throughout the process, they can ensure the appraisal remains properly tailored to the specific disputes at issue, that all the disputes at issue are being addressed within the parameters of the policy, and that the appraisal process itself does not lead to even further disputes or disagreements.

Parties and their counsel should also have the appraisal panel specifically itemize the damage being valued in the appraisal process. This itemization may allow the parties to better separate covered damage from non-covered damage, permit easy application of the policy terms and conditions, and further ensure the appraisal results in an unambiguous award that provides finality to the claim.

Finally, the appraisal panel should clearly state in the award whether and to what extent it considered causation issues. This statement further clarifies the panel's award and may avoid needless disputes as to whether the appraisal panel has exceeded its authority under applicable law. For example, the award could state:

- "This appraisal award does not address the cause of loss but only the amount to restore the building to its original condition."
- "This appraisal award does not address whether the hail damage was caused by the 2012 storm or a previous hail event."
- "This appraisal award does not take into consideration any coverage questions but only the amount to repair the damaged property."

In summary, by ensuring the appraisal process is well-defined and remaining vigilant as it progresses, the parties may avoid surprises, further disputes and potential litigation concerning the ultimate award.

2. Timing and Waiver: Use it or Lose it?

Another frequently-litigated question in the appraisal context is whether one party, either through its action or inaction, waived its contractual right to appraisal. A party seeking to avoid an appraisal may argue, for example, that the party demanding appraisal has forfeited its appraisal rights by delaying the demand for appraisal or opting to litigate the amount of loss. In some jurisdictions, courts have determined that a party may waive its right to appraisal if it maintains a

position "inconsistent with the appraisal remedy."[68] Other jurisdictions, however, have made it almost impossible to waive the right.

a. Timeliness of an Appraisal Demand: Within a Reasonable Period

In the appraisal context, a party may waive his rights to demand appraisal if he fails to invoke the provision in a timely manner. While some appraisal provisions provide for a specific time period during which appraisal must be demanded, other policies simply make appraisal available when the parties disagree as to the amount of loss or damage.[69] Where the policy does not specify a time limit for an appraisal demand, courts have generally concluded that such demand must be made "within a reasonable period."[70]

In determining what is "reasonable," courts conduct a factual review. For example, in a case involving a demand for appraisal in the context of the World Trade Center insurance coverage litigation, a New York federal court analyzed the following three factors in determining whether the timing of an appraisal demand was reasonable:

> (i) whether the appraisal sought is "impractical or impossible" (that is, whether granting an insurer's appraisal demand would result in prejudice to the insured party); (ii) whether the parties engaged in good-faith negotiations over valuation of the loss prior to the appraisal demand; and (iii) whether an appraisal is desirable or necessary under the circumstances.[71]

The court held that an insurer did not waive its appraisal rights, in part because the insured did not establish that the insurer's participation in the multi-party appraisal would be impossible or impractical. The court also found that good-faith negotiations regarding the amount of loss or damage were not a prerequisite to demanding appraisal.[72]

To determine whether timing of the appraisal demand was reasonable, the court and parties must identify and define the event or events that trigger a party's appraisal rights. Generally, the triggering event is the moment at which the parties have "reached an impasse" with respect to the value of the loss.[73] Identifying the precise moment of "impasse," however, is often a difficult task, particularly when parties are in the midst of the insurance adjustment process. A court's

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[68] *Gray Mart*, 703 So.2d at 1172; *see also Dwyer*, 565 F.3d at 287 ("Like any other contract term, the appraisal provision may be waived by conduct inconsistent with invocation of the provision."); *Lundy v. Farmers Group, Inc.*, 750 N.E.2d 314, 319 (Ill. App. Ct. 2001).

[69] *But see Johnson v. Mut. Service Cas. Ins. Co.*, 732 N.W.2d 340, 346 (Minn. Ct. App. 2007) (holding that two-year suit limitation provision contained in a property policy applied to bar demand for appraisal).

[70] *E.g., SR Int'l Bus. Ins. Co., Ltd. v. World Trade Ctr. Props. LLC*, 01 Civ. 9291 (MBM), 2004 U.S. Dist. LEXIS 25642, at *9 (S.D.N.Y. Dec. 1, 2004).

[71] *Id.* at *9-10.

[72] *Id.* at *14-15.

[73] *Terra Indus. Inc. v. Commonwealth Ins. Co. of Am.*, 981 F. Supp. 581, 599 (N.D. Iowa 1997); *In re Slavonic Mut. Fire Ins. Ass'n*, 308 S.W.3d 556, 562 (Tex. App. 2010); *see also Tamko*, 2009 U.S. Dist. LEXIS 121320, at *8-10; *Newman v. Lexington Ins. Co.*, Civ. Action No. 06-4668, 2007 U.S. Dist. LEXIS 25141, at *11-13 (E.D. La. Apr. 4, 2007).

inquiry with respect to the timing of the impasse is therefore fact-intensive and focuses on the specific conduct of each party.

Not all courts, however, have adopted the "impasse" standard for determining the time during which an appraisal demand must be made. For instance, Louisiana's highest court held that an insurer's demand for appraisal was not timely because the demand was not made within sixty days of receipt of a proof of loss.[74] The court read the sixty-day limitation into the appraisal clause based, at least in part, upon the language of the statutorily-sanctioned Louisiana standard fire policy, which requires payment of claims within sixty days after "satisfactory proofs of loss."[75]

b. How Long is Too Long?

In some cases, a waiver of appraisal rights may be found if a party actively litigates the amount of the loss or damage. For example, Connecticut's highest court held that by proceeding to trial upon the question of the amount of the loss, the insured waived his appraisal rights. The court therefore declined to disturb the jury's verdict, which denied damages to the insured, on the grounds that their insurer refused to submit to an appraisal.[76] Similarly, a Florida court held that an insurer waived its right to an appraisal by "actively and aggressively litigating" its case for over fourteen months and by not demanding an appraisal until approximately one month prior to the scheduled trial of the case – after its motion for summary judgment had already been denied.[77]

However, mere proximity to a trial date does not necessarily indicate that a waiver of appraisal rights has taken place. The Fifth Circuit Court of Appeals has rejected mere proximity between an insurer's request for appraisal and the trial date as grounds for finding waiver. Instead, the court recognized that the appropriate waiver inquiry should examine when the insurer knew the appraisal clause could be invoked and whether the insurer reacted to this information in a timely fashion.[78]

In fact, some jurisdictions go so far as to require intent – either intentional relinquishment of the right to appraisal or intentional conduct inconsistent with claiming the right to appraisal – and a showing of prejudice before finding waiver.[79] For example, in 2011, the Texas Supreme Court addressed appraisal waiver in *In re Universal Underwriters of Texas Insurance Co.* The court rejected the argument that the insurer waived its right to appraisal by not invoking the provision until one month after suit was filed, finding that the appraisal demand was made within a

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[74] *Sevier*, 485 So.2d at 1384.

[75] *Id.* at 1383.

[76] *Giulietti*, 534 A.2d at 217.

[77] *Gray Mart, Inc. v. Fireman's Fund Ins. Co.*, 703 So.2d 1170, 1171, 1173 (Fl. Ct. App. 1997); *see also Rogers v. State Farm Fire & Cas. Co.*, 984 So.2d 382, 387 (Ala. 2007) observing that waiver is established where a party "substantially invokes the litigation process and thereby substantially prejudices the party opposing [appraisal].")

[78] *Dwyer*, 565 F.3d at 288.

[79] *E.g., Rogers*, 984 So. 2d at 387-88; *see also In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404, 410 (Tex. 2011).

reasonable time after the parties reached an impasse.[80] The court further found that prejudice was a prerequisite to a finding of waiver.[81]

The *In re Universal* court explained that there are different ways to demonstrate that a party's legal rights or financial position have been negatively impacted in support of a showing of prejudice.[82] Prejudice may include inherent unfairness in terms of delay, expense, or damage to a party's legal position, purposefully and unjustifiably manipulating the exercise of arbitral rights to gain an unfair advantage over the opposing party, or causing an opposing party to incur expenses as a result of dilatory behavior.[83] Despite recognizing the potential ways in which a party could be prejudiced, the court commented:

> [I]t is difficult to see how prejudice could ever be shown when the policy, like the one here, gives both sides the same opportunity to demand appraisal. If a party senses that impasse has been reached, it can avoid prejudice by demanding an appraisal itself.[84]

Several courts applying Texas law have subsequently adopted the *In re Universal* court's reasoning.[85] Most recently, this language was embraced by the court in *Heller v. Ace European Group Ltd.*[86] Heller owned three residential properties he claimed were damaged by a hailstorm. He filed claims for each of the properties and the insurer, Ace, was on site adjusting the properties within five days. Just over a month later, Ace issued payments on two of the properties and notified Heller that the claim on the third property had been accepted but fell below the deductible.

Five months after the payments were issued and seven months after the hailstorm, Heller filed suit in state court, which was then removed to federal court. For over a year, Heller was uncooperative as the parties attempted to engage in discovery. Initially, Heller failed to respond to written discovery requests or provide court-ordered information. Heller was sanctioned by the court for these violations. Even after being sanctioned by the court, he failed to appear for his deposition, allow access to the property for inspection, or designate experts (even after the court granted a three-week extension). Fourteen months after suit was filed, the court granted three motions for summary judgment filed by Ace on Heller's misrepresentation, causation and prompt payment claims, sanctioned Heller for his discovery conduct, and denied Heller's request

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[80] *Universal,* 345 S.W.3d at 410.

[81] *Id.* at 411-12.

[82] *Id.* at 411.

[83] *Id.* (citing to *Perry Homes v. Cull,* 258 S.W.3d 580, 597 (Tex. 2008); *In re Tyco Int'l Ltd. Sec. Litig.*, 422 F.3d 41, 47 n.5 (1st Cir. 2005); and *Menorah Ins. Co. Ltd. v. INX Reinsurance Corp.*, 72 F.3d 218, 222 (1st Cir. 1995)).

[84] *Id.* at 412.

[85] *See In re Pub. Serv. Mut. Ins. Co.*, No. 03-13-00003-CV, 2013 WL 692441, at *5 (Tex.App. — Austin Feb. 21, 2013); *EDM Office Servs. Inc. v. Hartford Lloyds Ins. Co.*, No. H-10-3754, 2011 WL 2619069, at *5 (S.D. Tex. July 1, 2011); *Dike v. Valley Forge Ins. Co.,* 797 F.Supp.2d 777, 784 (S.D. Tex. June 23, 2011); *In re Cypress Tex. Lloyds,* No. 09-12-00077-CV, 2012 WL 1435739, at *1 (Tex.App. — Beaumont Apr. 26, 2012); *James v. Prop. & Cas. Ins. Co. of Hartford,* No. H-10-1998, 2011 WL 4067880, at *2 (S.D. Tex. Sep. 12, 2011); *Butler v. Prop. & Cas. Ins. Co. of Hartford*, No. H-10-3613, 2011 WL 2174965, at *1 n.3 (S.D. Tex. June 3, 2011).

[86] No. 7:12-CV-422, 2013 WL 6589253 (S.D. Tex. Dec. 16, 2013).

for more time to designate experts. Regardless, the court granted Heller's motion to compel appraisal.

Ace argued that Heller's conduct in the litigation waived his right to appraisal.[87] The court disagreed. In addition to finding that Ace had not established the first element of waiver — intent[88] — the court found that Ace was not prejudiced:

> [Ace] also claims prejudice due to [Heller]'s dilatory enforcement of the appraisal clause. Texas courts have found waiver where a party sits on its rights for an unreasonable time and thereby causes prejudice to the other party. However, as *Underwriters* points out, defendant could have avoided any putative prejudice by demanding appraisal, but did not.[89]

The court acknowledged that resorting to appraisal after over a year of litigation openly disregarded Texas' policy of encouraging appraisal as an alternative to litigation but nonetheless granted the motion to compel appraisal because appraisal could "still avoid some litigation in th[e] case."[90]

Again, whether and when a party waives its right to appraisal will depend on the governing law of the applicable jurisdiction. But given the perception that appraisal remains an effective alternative dispute resolution tool, it is likely that a court will not find waiver, even after a period of litigation, and will resolve doubts about waiver in favor of proceeding with the appraisal process.

c. *Practical Guidance for Initiating Appraisal*

Although courts are inclined to encourage appraisal as a means of avoiding litigation and are generally reluctant to find waiver, parties should not sit on their right to appraisal under the policy by unreasonably delaying an appraisal demand. To avoid a dispute concerning whether appraisal has been waived, parties should seek appraisal early – prior to suit being filed, if possible. Insurers should also seek the advice of counsel before denying a claim outright to ensure the denial will not waive the insurer's right to appraisal in a given jurisdiction.

Finally, a party resisting appraisal, based on the untimeliness of the demand or otherwise, should be aware of controlling law in the relevant jurisdiction. Whether appraisal will be compelled requires consideration of a number of factors other than mere timing of the demand, including the specific jurisdiction's interpretation of the scope of appraisal and potential applicability of statutes governing the process.

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[87] *Id.* at *7.

[88] *Id.*

[89] *Id.*

[90] *Id.* at *8.

3. The Appraisal Panel – Selecting Appraisers and an Umpire

a. Competent and Impartial Appraisers

The appraisal process *should be* conducted by two competent and impartial appraisers who do not have any financial interest in the award.[91] In fact, most policies require that each appraiser be "impartial" or "disinterested." In *Hall v. Western Assur. Co.*,[92] the court identified the importance of an impartial appraisal panel:

> The purpose of the clause is to secure a fair and impartial tribunal to settle the differences submitted to them. In their selection it is not contemplated that they shall represent either party to the controversy or be a partisan in the cause of either, nor is an appraiser expected to sustain the views or to further the interest of the party who may have named him. And this is true not only with respect to estimating the amount of the loss, but also with reference to the selection of an umpire. They are to act in a quasi judicial capacity, and as a court selected by the parties free from all partiality and bias in favor of either party, so as to do equal justice between them. This tribunal, having been selected to act instead of the court and in the place of the court, must, like a court, be impartial and nonpartisan. For the term "'disinterested' does not mean simply lack of pecuniary interest, but requires the appraiser to be not biased or prejudiced."[93]

While appointed appraisers will always attest to their competence and impartiality, the practical reality today is that an appraiser seldom disagrees with the position advanced by the party who appointed him. Therefore, courts will sometimes intervene to ensure that each party's appraiser is nonpartisan.[94]

Courts may void an appraisal award in its entirety if a party's appraiser was not disinterested per the policy's requirement. For example, in *Tamko Building Prods Inc. v. Factory Mut. Ins. Co.*,[95] the court found that the insurer's appraiser was interested as a matter of law because he sought the insurer's input on the umpire selection, allowed the insurer to review and comment on a draft of his appraisal presentation, and sought approval on whether he should agree to the amount ultimately calculated by the umpire.

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[91] *See Holt v. State Farm* Lloyds, CA 3:98-CV-1076-R, 1999 U.S. Dist. LEXIS 6257, *10-13 (N.D. Tex. Apr. 21, 1999); *Gen. Star Indem. Co. v. Spring Creek Village Apt. Phase V, Inc.*, 152 S.W.3d 733, 737 (Tex. App.—Houston [14th Dist.] 2004, no pet.); *Pa. Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm'n App. 1931, no writ).

[92] *Hall v. Western Assur. Co.*, 133 Ala. 637, 32 So. 257 (Ala. 1902).

[93] *Id.* at 639-40.

[94] *See Pa. Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm'n App. 1931, no writ) (citing *Del. Underwriters v. Brock*, 211 S.W.2d 779, 780 (Tex. 1919)).

[95] *Tamko Building Prods Inc. v. Factory Mut. Ins. Co.*, 890 F.Supp.2d 1129, at 1140-41 (E.D.Mo. Aug. 21, 2012).

The court also found that the appraiser's prior dealings with the insurer rendered him interested because of an indirect financial interest in the outcome of the appraisal. Namely, the appraiser had previously worked on 26 matters for the insurer and held a significant ownership interest in an accounting firm whose annual business earned between 4 and 7 percent from the insurer. The court also observed that the appraiser had personally cultivated the relationship between the insurer and his firm by hosting lunches, dinners, sporting events and office visits. The court noted that his "ongoing and future business prospects" with the insurer rendered him interested as a matter of law.[96]

Most policies and statutes specify that if the appraisers cannot agree on the amount of loss, an umpire should be selected by agreement of the appraisers or by court appointment. However, because appraisers have essentially become advocates of their client's positions, thereby eschewing their purpose as set forth in *Hall*, often the appraisers fail to reach *any* agreement without an umpire.

b. *Impartial Umpires*

Like appraisers, umpires should be impartial. If an umpire is found to be biased towards one party, the appraisal award may be vacated. For example, in *Weinger v. State Farm Fire & Casualty Co.*, a Florida appellate court voided an appraisal award because it found that the umpire's prior business dealings with the insurer rendered the umpire partial.[97]

In the past, appraisers made a good faith effort to reach agreement on the selection of a neutral umpire. Recently, however, for the same reasons appraisers fail to agree on the amount of loss, they also often fail to agree on an umpire and court intervention is increasingly required. These disagreements are sometimes fueled by the growing role of the appraisers as advocates for their client's positions and frequently result in a "race to the courthouse" in an attempt to appoint a "preferred" umpire. All too often, these efforts to obtain court appointment of an umpire are undertaken by one party without notice to the other, at the expense of one party's procedural due process rights to notice and an opportunity for hearing before the court takes action. Even more concerning is the willingness of some courts to entertain such unilateral applications, often by non-lawyer appraisers, with little if any regard for whether the party without notice is represented by counsel.

The court in *In the Matter of the Appraisal of Church Mutual Claim No. 1171752 between Church Mutual Insurance Company and Paul Quinn AME Church*,[98] addressed the calamity that is often associated with the process of umpire selection. In *Church Mutual*, the parties invoked the appraisal provision to assist with valuation of a fire loss. The appraisers could not reach agreement on valuation and were unable to agree on a neutral umpire. Accordingly, the insurer filed suit on January 29, 2013 in federal court requesting appointment of an umpire. The insured then filed a *separate* suit in March 2013 in state court seeking appointment of its chosen umpire.

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96 *Id.* at 1141.

97 *Weinger v. State Farm Fire & Cas. Co.*, 620 So.2d 1298 (Fla. App. 1993).

98 *In the Matter of the Appraisal of Church Mutual Claim No. 1171752 between Church Mutual Insurance Company and Paul Quinn AME Church*, Case No. A-13-CA-079-SS (W.D. Tex. Aug. 30, 2013).

The court found that the first-to-file insurer had standing to bring suit in federal court and rejected the insured's motion to dismiss in favor of the pending state court suit. The court recognized the incongruent nature of the pending suit in the context of appraisal and urged the parties to work together to resolve the appraisal and umpire disputes without court intervention:

> [T]he Court will direct the two appraisers to confer, either in person or by telephone—not by email—and attempt to select an umpire. In the hopes of making a fresh start, each appraiser shall propose a list of three possible umpires, none of whom have been previously proposed. At least two of the nominees must be qualified in either building construction, or smoke damage repair. Thereafter, the parties will report to the Court on the substance of the appraiser's conference, including the names and qualifications of the proposed umpires. If the Court finds the parties and their appraisers have acted in bad faith, by proposing manifestly unsuitable umpires, or failing to substantively confer, monetary sanctions may well issue, against one or both parties. If the appraisers still cannot agree on an umpire, the Court will accept three nominations from each party, at least two of whom must have the aforementioned experience or qualifications. However, the Court will not be bound to appoint an umpire from either party's list, and reserves the right to appoint an umpire of the Court's choosing—possibly one who, while he may not like climbing on roofs, is known to the Court to be fair and impartial.[99]

Disputes concerning umpire appointment are often in neither party's best interest. The *Church Mutual* court's language recognized the dysfunction that a "race to the courthouse" entails, including the parties' potential identification of unqualified (and probably partial) umpires.[100] Moreover, a court-appointed umpire selected by a judge is often not qualified to understand the specific type of property loss dispute at issue. It is therefore the best practice to encourage appraisers to identify an umpire with a background and experience in the loss at issue and make their best efforts to agree on the appointment.

c. *Practical Guidance Regarding Appraisers and Umpires*

To ensure that the appraisers and umpire selected are competent and impartial, the parties should be sure to perform due diligence in researching the involved appraisal panel candidates before they are appointed. By fully understanding the relationships between and among the parties and the appraisal panel, including the amount of work the panel candidates may have historically performed for the specific parties involved or more generally for plaintiffs versus defendants or insureds versus insurers, the parties may identify unknown biases and avoid challenges to the

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[99] *Id.* at *6.

[100] Notably, the court in the *Church Mutual* matter was, in the end, forced to appoint an umpire because the parties could not agree to one. Noting that it was a "troublesome case where parties do not seem to be able to agree on anything but to infer insults on the other in their conduct, emails, and pleadings," the court selected an attorney mediator with a background in construction and contract mediation and arbitration as the umpire. *See* October 7, 2013 Order.

appraisal award down the road. For the same reasons, parties should also avoid frequent retention of the same appraiser.

If the parties' appraisers cannot reach agreement on valuation or an umpire, appointment of an umpire by a court having jurisdiction is necessary. In today's reality, if the parties are already at an impasse in the appraisal process, it is likely that they will not be able to agree on an umpire. In that case, it is almost always in a party's best to be the first to seek court appointment of an umpire, with notice to the opposing party. This not only reduces the possibility that an umpire will be appointed by a court without notice to both parties and the likelihood of a legal challenge to the award, but it also provides an opportunity for the requesting party to propose qualified umpire candidates with particular expertise in the subject matter of the dispute.

Once empaneled, the parties should ensure that the appraisers and umpire are given clear instructions concerning what is expected of them (*i.e.* the scope of appraisal should be made clear). This will allow the appraisal panel to fully address all the issues necessary for resolving the dispute and issue an award to which the policy terms and conditions can be unambiguously applied. In some instances, an unqualified or biased umpire may disregard the appraisers' positions and issue an award out of left field. But if the parties ensure that the scope of the appraisal is well-defined and the issues for the umpire's review are specifically delineated, the umpire will be forced to stay within those confines. If the appraisal award ultimately ignores the defined scope and issues, the parties will be given more leverage to later vacate the award. Establishing these parameters for the appraisal process could involve the use of an appraisal protocol, which is discussed more fully below.

Finally, the typical appraisal provision does not prevent parties and their appraisers from assembling an "appraisal team." This team can consist of an impartial appraiser, such as an independent adjuster, and various experts that may be retained to support the appraiser's analysis and ultimate valuation decision. This approach may be particularly helpful in large, complex claims involving numerous issues and requiring expertise in various areas that may be beyond the qualifications of any single appraiser. By relying on a team of qualified experts for support in the appraisal process, the appraiser's valuation has a solid foundation and is more likely to be viewed as competent and impartial, not to mention persuasive to the umpire.

4. Enforcing the Appraisal Award

Once the amount of loss is determined by the appraisal process, the policy (or applicable statute) contemplates that it will be binding on the parties.[101] Nevertheless, parties may try to avoid the appraisal award via challenge. Courts generally set high standards for such challenges, however, recognizing that "[e]very reasonable presumption will be indulged to sustain an appraisal award."[102]

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[101] *Scottish Union & Nat'l Ins. Co. v. Clancy*, 8 S.W. 630, 631 (Tex. 1888) ; *Franco v. Slavonic Mut. Fire Ins. Ass'n*, 154 S.W.3d 777, 786 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (citing *Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist.*, 877 S.W.2d 872, 875 (Tex. App.—San Antonio 1994, no writ)).

[102] *Franco v. Slavonic Mut. Fire Ins. Ass'n*, 154 S.W.3d 777, 786 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (citing *Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist.*, 877 S.W.2d 872, 875 (Tex. App.—San

In most states,[103] an appraisal award may be challenged, however: (1) when the award is made without authority; (2) when the award results from fraud, accident, or mistake; and (3) when the award was not made in substantial compliance with the policy.[104] The burden of proof is high and is born by the party seeking to nullify the appraisal. Courts have made it exceedingly difficult to avoid payment pursuant to an appraisal award that was entered in compliance with the policy terms and within the authority of the appraisal panel.

In the end, a party should not expect a court to vacate an appraisal award. Therefore, parties should do everything possible at the front end of the process to ensure a fair award. Regardless, a party and its counsel should watch the process carefully for bias, bad faith, and mistakes. Once an award is made, the parties and/or counsel should carefully review it to ensure it was entered within the agreed scope of the appraisal process. This is particularly important in a jurisdiction that has expanded the scope to permit appraisal panels to determine issues of causation, as the line between causation and damages is not always clear and may subject the award to legal challenge.

5. Use of an Appraisal Protocol

One of the best tools parties can use to avoid the pitfalls associated with today's appraisal process is the appraisal protocol. This is a separate agreement entered outside the insurance policy contract that defines the scope of appraisal and, among other things, specifically requires the appraisal panel to identify the scope of damage considered. It also delineates the actual process the appraisal panel should follow to ensure fairness and impartiality.

An effective appraisal protocol will prescribe the specific form of the award, define any relevant terms the appraisal panel will use (such as replacement cost value and actual cash value), include a disclaimer shielding the appraisal panel from liability, and incorporate anything else deemed appropriate by the parties given the circumstances of the loss.

An appraisal protocol provides guidance to the panel. It defines and protects the parties' mutual expectations and interests and minimizes possible abuse of the process. If the appraisal panel follows the protocol, the risk of collateral attack of the award is minimized. Therefore, while not required by the policy itself, if the parties can reach agreement on a protocol, it becomes an enforceable contract that provided much greater guidance to the panel than the short appraisal provision found in most policies.[105]

C. Conclusion

While appraisal can be a useful tool in the resolution of disputed property insurance claims, it can be abused by parties attempting to broaden its permissible scope, using partial appraisers and umpires with their own agendas, and lodging unsupported challenges to the award, thereby

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Antonio 1994, no writ) (citing *Cont'l Ins. Co. v. Guerson*, 93 S.W.2d 591, 594 (Tex. Civ. App.—San Antonio 1936, writ dism'd))).

[103] The elements necessary to challenge an appraisal award are state specific.

[104] *Franco*, 154 S.W.3d at 786; *Wells*, 919 S.W.2d at 683-85; *Providence Lloyds v. Crystal City Indep. School Dist.*, 877 S.W. 872, 875 (Tex. App.—San Antonio 1994, no writ); *St. Charles*, 681 F. Supp. 2d at 760.

[105] A sample appraisal protocol is attached as Exhibit A.

nullifying its usefulness as an alternative tool for dispute resolution. As advocates for the insured or insurer, attorneys can best bring value and finality to the appraisal process by working with their clients to ensure the appraisal panel has a well-defined scope and specific instructions concerning the parties' expectations within the parameters of the insurance policy. In the end, parties and counsel who find themselves involved in the appraisal process should consider these recommendations:

- **Pay Attention** – Parties and their counsel should not simply turn over the appraisal process to their assigned appraisers, rely on them to identify the disputes and set the parameters for the appraisal, and then hope for the best. Attacking an appraisal award after the fact by challenging the process by which it was entered will likely be too little, too late. But if the parties and their counsel pay attention throughout the process, they can ensure the appraisal remains properly tailored to the specific disputes at issue, that all the disputes at issue are being addressed within the parameters of the policy, and that the appraisal process itself does not lead to even further disputes or disagreements.

- **Research the Involved Parties** – Parties and their counsel should know the relationships amongst the appraisers, umpires, consultants, adjusters, public adjusters, and contractors involved in the appraisal process. This will reveal any innate biases that should be addressed at the start of the process and perhaps avoid the need to challenge the appraisal award later.

- **Document Everything** – It is important for parties to establish a paper trail on all agreements throughout the process. The days of handshake agreements are unfortunately over. An appraisal protocol can best address how these agreements will be memorialized.

- **Retain Strong Appraisers** – Despite the fact that appraisers are supposed to be disinterested, the reality is that appraisal has become an adversarial process with appraiser advocates on each side. Therefore, identifying qualified appraisers who have a solid foundation for their opinions is key. The use of an expert "appraisal team" can also be beneficial in the right claim.

- **Confirm the Scope of Appraisal** – To ensure the appraisal award meets the parties' expectations, there should be no ambiguities as to what issues the appraisal panel considered and the scope of the award. The parties should work together to ensure the appraisal panel knows what is expected of them.

- **Enforce Your Rights** – Parties should enforce the policy provisions and refuse to accept manipulation of those provisions or fraud in the process. Again, by being vigilant at the start of the process and defining the parties' expectations in an appraisal protocol, parties can avoid manipulation, a race to the courthouse, and other abuses that are common in modern appraisals.

By following these recommendations, many of the pitfalls associated with modern property insurance appraisals may be avoided. And avoiding these pitfalls brings parties back to fulfilling the purpose and intent behind the appraisal process as a means of alternative dispute resolution – to avoid the expense and frustration of litigation.

The views and opinions expressed in this paper are solely those of the authors and do not reflect the views or opinions of Zelle Hofmann Voelbel & Mason LLP or any of its clients, or Argonaut Group or any of its insureds.