ALFA International
THE GLOBAL LEGAL NETWORK

# 2023 Insurance Roundtable

## May 31 – June 2, 2023

## First Party Property Appraisals

*It's Not As Easy As It Looks*


Matthew J. Gray
Moderator
YOUNG MOORE AND HENDERSON, P.A.
Raleigh, North Carolina
matt.gray@youngmoorelaw.com

Marcie L. Schout
QUILLING, SELANDER, LOWNDS, WINSLETT & MOSER, P.C.
Dallas, Texas
mschout@qslwm.com

# First Party Property Appraisals—It's Not as Easy as It Looks

The idea of appraisal in the context of a first party property insurance claim seems straight forward enough. If the insurer and the insured disagree about the "amount of loss" either can invoke appraisal and an appraisal panel will resolve that dispute quickly and efficiently, and then the parties will easily resolve the claim with no further dispute. The reality is more complicated.

## The Basics—What is Appraisal

In the first party property insurance context, appraisal is a process that is used to resolve disputes between an insurer and a policyholder over the value of a property damage claim. Appraisal is a contractual process that is typically triggered when the parties cannot agree on the amount of the loss. It is governed by the terms of the insurance policy, sometimes supplemented by statute. While variations in appraisal provisions exist, the basics are substantively similar across policy forms. The ISO appraisal provision appears in the Conditions section and states:

> Appraisal
>
> If you and we fail to agree on the amount of loss, either may demand an appraisal of the loss. In this event, each party will choose a competent and impartial appraiser within 20 days after receiving a written request from the other. The two appraisers will choose an umpire. If they cannot agree upon an umpire within 15 days, you or we may request that the choice be made by a judge of a court of record in the state where the "residence premises" is located. The appraisers will separately set the amount of loss. If the appraisers submit a written report of an agreement to us, the amount agreed upon will be the amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will set the amount of loss.
>
> Each party will:
>
> 1. Pay its own appraiser; and
> 2. Bear the other expenses of the appraisal and umpire equally.

In most policies, appraisal can be invoked by either party, and once invoked, the other party appoints its own appraiser and they compare competing positions about the amount of loss. They then try to reach an agreement, and if they cannot, they agree on an umpire. A decision signed by any two sets the amount of loss.

## What Is the Amount of Loss—What Issues Can Be Considered

While "amount of loss" may sound straight forward, in practical application it is complicated. On one end of the spectrum is a straight-forward case where both sides agree the roof was damaged by hail and requires replacement, but the insured thinks the roof will cost $100,000 to replace, while the insurer thinks it can be replaced for $25,000. That is clearly a disagreement about the amount of the loss. On the other end of the spectrum is the scenario where the insured believes the roof requires replacement because of hail damage and the insurer believes that the roof either does not require replacement, or if replacement is required, it is due to wear and tear, improper installation or maintenance or other excluded causes of loss. In that second situation, the question is whether the issue of causation is properly part of the "amount of loss" determination in the scope of appraisal. Below is a list of cases from some jurisdictions that have considered this issue:

- Alabama—*Rogers v. State Farm Fire and Cas. Co.*, 984 So.2d 382, 392 (Ala. 2007) (holding that amount of loss is narrowly constrained to "the monetary value of the property damage—and that appraisers are not vested with the authority to decide questions of coverage and liability", including issues of causation).
- Florida—*Johnson v. Nationwide Mut. Ins. Co.*, 828 So.2d 1021, 1022 (Fla. 2002) (holding "causation is a coverage question for the court when an insurer wholly denies that there is a covered loss and an amount-of-loss question for the appraisal panel when an insurer admits there is a covered loss, the amount of which is disputed.")
- Iowa—*Walnut Creek Townhome Ass'n v. Depositors Ins. Co.*, 913 N.W.2d 80, 91 (Iowa 2018) (holding that "appraisers may decide the factual cause of damage to property in determining the amount of the loss from a storm" and such a decision is binding on the court).
- Minnesota—*Quade v. Secura Ins.*, 814 N.W.2d 703, 706 (Minn. 2012)(holding that an appraiser's assessment of the amount of loss "necessarily includes a determination of the cause of the loss, and the amount it would cost to repair that loss.")
- Rhode Island—*Hahn v. Allstate Ins. Co.*, 15 A.3d 1026, 1030 (R.I. 2011) (holding that "unless the insurer denies coverage for the claimed loss and if the dispute is limited to the amount or extent of loss, the parties are required to submit to the appraisal process.")
- Texas—*State Farm Lloyds v. Johnson*, 290 S.W.2d 886 (Tex. 2009) (holding "any appraisal necessarily includes some causation element, because setting the 'amount of loss' requires appraisers to decide between damages for which coverage is claimed from damages caused by everything else.")

In response to this issue, some appraisal provisions are drafted to specifically delineate the scope of appraisal and whether causation issues can be determined as part of the amount of loss. *See e.g. N. Carolina Farm Bureau Mut. Ins. Co. v. Sadler*, 365 N.C. 178, 182, 711 S.E.2d 114, 117 (2011) (policy includes provision "In no event will an appraisal be used for the purpose of interpreting any policy provision, determining causation or determining whether any item or loss is covered under this policy. If there is an appraisal, we still retain the right to deny the claim.").

## Who Can Serve as Appraiser

Most appraisal provisions require the appointment of a "competent and impartial," "competent and disinterested" or "competent and independent" appraiser. The Colorado Supreme Court applied the plain meaning of impartial and determined that a requirement for impartiality requires "an appraiser to be unbiased, disinterested, without prejudice, and unswayed by personal interest." *Owners Ins. Co. v. Dakota Station II Condo. Ass'n.*, 443 P.3d 47, 53 (Colo. 2019). Applying the plain and ordinary meaning, "disinterested" has recently been defined by the Florida Supreme Court "[f]ree from bias, prejudice, or partiality and therefore able to judge the situation fairly; not having a pecuniary interest in the matter at hand" and "1: lacking or revealing lack of interest ... apathetic ... 2: not influenced by regard to personal advantage: free from selfish motive: not biased or prejudiced." *Parrish v. State Farm Florida Ins. Co.*, 356 So.3d 771, 776 (Fla. 2023). Who fits this bill will be dependent on the specific facts of a claim, but there are some specific categories of players who repeatedly appear in the appraisal context.

### *Public adjusters*

In many states, public adjusters obtain a contingent fee interest in a policyholder's claim to assist the policyholder in interfacing with the insurer to adjust the claim. Recently, the Florida Supreme Court held that the president of the public adjusting firm that held a contingent fee interest in a claim could not serve as a "disinterested" appraiser. *Parrish v. State Farm Florida Ins. Co.*, 356 So.3d 771, 778 (Fla. 2023). Other courts have held that a public adjuster who has a contingent fee interest in the property claim cannot be disinterested. *See e.g. Shree*

*Hari Hotels, LLC v. Soc'y Ins.*, No. 1:11-CV-01324-JMS, 2013 WL 4777212, at *2 (S.D. Ind. Sept. 5, 2013).

In some states, even where a public adjuster no longer holds a contingent interest, a public adjuster who was involved in adjusting the claim on behalf of a policyholder may not be "impartial". *Vidhi LLC v. Arch Ins. Co.*, No. 3:18-CV-451-JD-MGG, 2019 WL 13163440 (N.D. Ind. Aug. 13, 2019). "Previous service, together with other circumstances, may disqualify." *Id.* In *Vidhi*, the court concluded that the appraiser had a professional interest in affirming the substance of his opinions about the insurer's alleged mishandling of the claim. *Id.* The court equated it to a situation where a new judge had previously advocated for one of the parties in a case before taking the bench. *Id.*at *4.

Some states have legislation prohibiting a public adjuster from acting as an appraiser if the public adjuster has been involved in adjusting the claim that is being appraised. *See e.g.* La. Stat. Ann. § 22:1706; 28 Tex. Admin. Code §5.4212 (applying to claims made on policies issues by Texas Windstorm Insurance Association).

### *Pre-existing relationship and repeat appointments*

Even where a party is repeatedly appointed as an appraiser to represent one side or the other, be it the insurer or the policyholder, those repeat appointments are typically insufficient to make the appraiser partial or interested. *Tiger Fibers, LLC v. Aspen Specialty Ins. Co.*, 571 F. Supp.2d 712 (E.D. Va. 2008); *see also Sankey v. Texas Windstorm Ins. Ass'n.*, 2022 WL 1178963, at *10 (Tex. App.—Corpus Christi-Edinburg Apr. 21, 2022, no pet.) (appointment by insurer in dozens of other Hurricane Harvey claims did not establish bias or partiality).

A Texas court has concluded that a pre-existing consultant relationship between an insurer and an engineering firm, including seven years of appointments to perform consulting work for the insurer, would not prevent employees of the engineering firm from serving as an appraiser. *Grander v. State Farm Lloyds*, 76 S.W.3d 140 (Tex. App.—Houston [1st Dist.] 2002, no pet.). "The showing of a pre-existing relationship, without more, does not support a finding of bias." *Franco v. Slavonic Mut. Fire Ins. Ass'n.*, 154 S.W.3d 777, 786 (Tex. App.—Houston [14th Dist. 2004, no pet.). In Texas, this principle extends even where the outside consultant served as a consultant on the exact claim that is the subject of the appraisal, so long as the evidence suggests that the appraiser's opinion and conclusions were his own and the insurer did not influence or exert control over the appraiser. *Id.; but see Mahnke v. Superior Court*, 180 Cal. App. 4th 565, 580, 103 Cal. Rptr. 3d 197,207 (2009) (finding disqualification of appraiser may be appropriate where there is a "substantial business relationship between the party and the appraiser or the appraiser's company).

### *Attorney for Party as Appraiser*

An attorney for a party cannot be a "disinterested" or "impartial" appraiser given the duty of loyalty owed by an attorney to his client. *Florida Ins. Guar. Ass'n v. Branco*, 148 So.3d 488 (Fla. 5th DCA 2014).

## What to Do With An Appraisal Award

The standard appraisal provision provides that a decision agreed to by a combination of any two of the appraisers and umpire will be binding to set the amount of the loss. But that does not mean that upon receipt of an appraisal award that the insurer simply pays the amount set out in the award. Instead, the policy will be applied to the award. For example, if the policy provides for payment on the actual cash value basis (with deduction for depreciation) until repairs are made, it may be permissible for the award to be paid on an ACV basis. See *Woodcrest Capital, LLC v. Zurich Am. Ins. Co.*, No. 20-CV-00130-DC, 2021 WL 5234970, at *10 (W.D. Tex. Aug, 11, 2021); *see also Island Roofing & Restoration LLC v. Empire Indem. Ins. Co.*, No. 2:21-CV-211-JLB-KCD, 2022 WL 4305922, at *7 (M.D. Fla. Sept. 19, 2022). The deductible and prior payments can also be applied, though it is prudent to ensure that appraisal awards include language making clear that they did not take into account

deductible or prior payments to ensure that there is no question about this.

The bigger and more complicated issue is how coverage issues are applied to the award. In a jurisdiction where the "amount of loss" includes the consideration of whether the damage was caused by a covered cause of loss as opposed to a non-covered cause of loss like wear and tear or pre-existing conditions, the appraisal award will be binding, and if those issues were determined in the appraisal, the insurer will be precluded from litigating those issues. *In re Auto Club Indem. Co.*, 580 S.w.3d 852 (Tex. App.—Houston [14th Dist.] 2019, no pet.) In this regard, it is important to consider the actual appraisal award and process and the issues that were actually determined to determine if the causation-type issues were actually determined by the appraiser. *Texas Windstorm Ins. Assoc. v. Dickinson Independent School District*, 561 S.W.3d 263 (Tex. App.—Houston [14th Dist.] 2018, pet. denied). To the extent there are other coverage issues, like the application of a cosmetic damage exclusion, that were not determined within the appraisal process, the issues can be raised after the appraisal as reasons not to pay the appraisal award. *Horton v. Allstate Vehicle & Prop. Ins. Co.*, No. 4:20-CV-3109, 2022 WL 7265953, at *6 (S.D. Tex. Sept. 9, 2022)

## Bad Faith Issues Following Appraisal

Be aware that in some jurisdictions, simply timely paying an appraisal award after the award is issued may not cut off all bad faith liability. Texas is a case study in how these issues can apply based on recent developments in the case law and how policyholders' counsel are pushing the envelope.

Prior to 2019, the argument in Texas was that if an insurer timely paid an appraisal award, it cut off any further liability for breach of contract or bad faith cause of action. The Texas Supreme Court rejected that argument in *Barbara Technologies Corp. v. State Farm Lloyds*, 589 S.W.3d 806 (Tex. 2019); *Ortiz v. State Farm Lloyds*, 589 S.W.3d 127 (Tex. 2019). In *Ortiz*, the court clarified that where an insurer timely pays an appraisal award, it cuts off any breach of contract and related damages because that insurer complied with the insurance policy. 589 S.W.3d at 132-33. But, if the insured could establish that the insurer's conduct in refusing to pay the claim prior to appraisal resulted in damage "independent from the loss of policy benefits." *Id.* at 135. North Carolina has similarly found that payment of an appraisal award does not necessarily extinguish all claims of an insured. See *Hill v. Church Mutual Ins. Co*., No. 7:20-CV-00254, 2022 WL 2705242, (E.D.N.C. July 12, 2022) (holding that plaintiff failed to allege facts to support a breach of contract claim where the appraisal award was timely paid, but that plaintiff's allegations about Church Mutual's claim-handling practices stated plausible bad faith and unfair and deceptive trade practice claims.)

In 2021, the Texas Supreme Court further clarified that penalty interest under the Texas prompt payment statute may be owed, even if the insurer paid what it believed was a reasonable amount pre-appraisal, if that payment did not "roughly correspond" to the ultimate amount of the appraisal award. *Hinojos v. State Farm Lloyds*, 619 S.W.3d 651 (Tex. 2021). Because a prompt payment claim also entitles an insured to recover attorney's fees, many insurers in Texas have begun to voluntarily pay prompt payment interest on the appraisal award payment in an attempt to cut off any claim for attorneys' fees. Despite that, some policyholder counsel have continued to pursue claims to recover attorney's fees, and there is a split in authority. Almost all federal district courts who have considered the issue have concluded attorney's fees should not be awarded in that situation because it is not possible for the insured to recover actual damages. *See e.g. Arnold v. State Farm Lloyds*, No. CV H-22-3044, 2023 WL 2457523, at *5 (S.D. Tex. Mar. 10, 2023). A Texas intermediate court reached a contrary conclusion and affirmed an award of $96,358.50 in attorney's fees where there was no breach of contract because the appraisal award was timely paid and where prompt payment interest was voluntarily paid in full. *Texas Fair Plan Assoc. v. Ahmed*, 654 S.W.3d 488 (Tex. App.—Houston [14th Dist.] 2022, pet. denied).