ATTACKING AND DEFENDING THE APPRAISAL AWARD

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I. INTRODUCTION

Appraisal is a process frequently found in many insurance policies but is most commonly used in property damage situations. The language will usually state that appraisal is mandatory when properly demanded by the insurer or insured. When properly executed, appraisal is binding on the parties as to the amount of loss only. However, many times appraisal is improperly invoked, employed, and/or carried out. Appraisals are frequently carried out without attorneys, usually just between the insurer and the insured.

Appraisal is not arbitration. In arbitration, all contested issues are submitted to an arbitrator(s) for resolution while in appraisal only the amount of loss is decided by two (2) appraisers and an umpire, if necessary. Arbitration and appraisal are alike in that arbitrators, appraisers, and umpires are to be impartial, independent, and free from bias. Arbitration is formal in nature functioning somewhat like a court while appraisal is an informal process conducted by two (2) appraisers who determine solely the amount of loss. If the two (2) appraisers disagree, then an umpire is chosen by the parties to resolve differences; if the appraisers cannot agree on an umpire then frequently a court is petitioned to appoint one.

The appraisal language in a policy typically reads as follows:

Appraisal. If you and we fail to agree on the actual cash value, amount of loss, or cost of repair or replacement, either can make a written demand for appraisal. Each will then select a competent, independent, appraiser and notify the other of the appraiser's identity within 20 days of receipt of the written demand. 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 district court of a judicial district where the loss occurred. The two appraisers will then set the amount of loss, stating separately the actual cash value and loss to each item.

If the appraisers fail to agree, they will submit their differences to the umpire. An itemized decision agreed to by any two of these three and filed with us will set the amount of loss. Such award shall be binding on you and us.

Each party will pay its own appraiser and bear the other expenses of the appraisal and umpire equally.

Traditionally, appraisal is employed to determine the amount of loss and nothing more. The appraisal clause can be invoked by either party when a determination on the amount of loss is all that is at issue. However, a recent Texas Supreme Court decision has altered the scope of appraisal in certain circumstances, an issue which this paper will address below.

II. THE LAW REGARDING APPRAISAL IN TEXAS

A. The Basics

Appraisal is not arbitration. In *Re Allstate Ins. Co.*, 85 S.W.3d 193, 195 (Tex. 2002); *Scottish Union National Ins. Co. vs. Clancy*, 71 Tex. 5, 8 S.W.3d 630, 631 (1988). In theory, appraisal is to be used to provide a simple, speedy, inexpensive, and fair method of determining the amount of loss only. *Fire Ass'n vs. Ballard*, 112 S.W.2d 532, 534 (Tex. Civ. App. - Waco 1938, no writ). If a lawsuit is filed and one party properly demands appraisal, abatement is not required. *In Re Allstate Ins. Co*. at 85 S.W.3d 193, 195 (Tex. 2002). If appraisal is properly invoked, carried out, and awarded, the amount of loss is binding on the insurer and the insured. *Clancy*, 8 S.W. at 631; *Standard Fire Ins. Co. vs. Fraiman*, 514 S.W.2d 343, 344-345 (Tex. Civ. App. - Houston [14th Dist.] 1974, no writ).

Appraisal clauses were traditionally inserted for the insurer's benefit and may be waived. *Ins. Service Co. vs. Brodie*, 337 S.W.2d 414, 415 (Tex. Civ. App. - Fort Worth 1960, writ ref'd n.r.e.). However, either the insurer and/or the insured may invoke appraisal. The insurer "will not be permitted to use this clause oppressively, or in bad faith." *Id.* at 417.

Absent agreement between the parties, appraisal has customarily been used to determine the amount of loss only. *Wells vs. American States Preferred Ins. Co*., 919 S.W.2d 679, 684 (Tex. App. - Dallas 1996, writ denied). Until recently, appraisers and umpires have had no authority or power in an appraisal to determine "questions of causation, coverage, or liability..." *Id.* However, the Supreme Court's 2009 opinion in *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009), has slightly altered this approach, and this paper will analyze those issues below.

The appraisal language requires that a demand for appraisal must be in writing. Usually, the language also addresses certain time limits for naming appraisers and umpires, how appraisal is to be accomplished, who pays the costs of appraisal, and the appointment of an umpire. Additionally, insurers sometimes use a written memorandum of appraisal for the appraisers and/or umpire to sign. The memorandum often includes the property damaged, the date of loss, the cause of the loss, and sometimes an oath for an appraiser to sign. The typical policy language does not mandate any memorandum of appraisal.

B. Timeliness and Waiver In Demanding Appraisal

While policy language does not usually address the timing of appraisal, Texas courts have held that demand for appraisal must be made within a reasonable time. *American Fire Ins. Co. vs. Stuart*, 38 S.W. 395 (Tex. Civ. App. - 1996, no writ) (58 day delay); *Boston Ins. Co. vs. Kurley*, 281 S.W. 275 (Tex. Civ. App. - Eastland 1926, no writ) (59 day delay). An insurer must move promptly to determine the amount of loss. *Brodie*, 337 S.W.2d at 417. Thus, these cases demonstrate that once an insurer or insured recognizes that a dispute over the amount of loss exists and is not capable of resolution, the proponent of appraisal should promptly demand appraisal in writing. Otherwise, appraisal can be waived.

Furthermore, the demand for appraisal must be invoked properly. The demand must not only be timely but in substantial compliance with the terms of the policy. In *Ins. Service Co. vs. Brodie*, 337 S.W.2d 414, 415 (Tex. Civ. App. - Fort Worth 1960, writ ref'd n.r.e.), the insurer improperly appointed one individual and two companies as appraisers. *Id.* The Court found that this appointment did not comply with the policy's provisions. *Id.* Brodie filed suit some forty-two (42) days after the insurer demanded appraisal. *Id.* The demand for appraisal took place seventy-two (72) days after the adjuster had viewed and examined the loss. *Id.* at 416. The *Brodie* court agreed the demand for appraisal was untimely, waived, and not in compliance with the policy.

Waiver of the appraisal clause can occur in other ways. An acceptance of a proof of loss waives appraisal. *Springfield Fire & Marine Ins. Co. vs. Cannon*, 46 S.W. 375 (Tex. Civ. App. 1898, no writ); Stuart, 38 S.W. at 395. Likewise, retention of a proof of loss for unreasonable time without demanding appraisal waives this condition. *Gulf Ins. Co. vs. Carroll*, 330 S.W.2d 227, 231 (Tex. Civ. App. - Waco 1959, no writ); *Kurley*, supra; and *American Central Ins. Co. vs. Heath*, 29 Tex. 445, 69 S.W. 235 (Tex. Civ. App. - 1902, no writ). An insurer who demands appraisal and fails to participate any further has waived the condition. *Northern Assurance Co. vs. Samuels*, 33 S.W. 239 (Tex. Civ. App. - 1895, no writ). Where an invalid appraisal has occurred, no further appraisal is required. *Security Ins. Co. vs. Kelley*, 196 S.W.2d 874, 878 (Tex. Civ. App. - Amarillo 1917, writ ref'd); *Wells*, 919 S.W.2d at 686-687. And, of course, where the insurer flatly denies the claim, the appraisal clause is waived.

C. The Requirement of Competent and Disinterested Appraisers

Texas law requires appraisers to be competent and disinterested. The appraiser is not obligated to either party to the appraisal, not required to represent either party's views or position, and not to be biased. *Pennsylvania Fire Ins. Co. vs. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm'n App. 1931, no writ). An appraiser is not the selecting party's expert or independent contractor.

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 or either, nor is an appraiser expected to sustain the views or to be further the interest of the party who may have named him. And this is true, not only with respect to estimating the amount of 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. The 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. "… [T]he term "disinterested" does not mean simply lack of pecuniary interest, but requires the appraiser to be not biased or prejudiced. And, if this provision of the policy was not carried out in this spirit and for this purpose, neither party is precluded from going to the courts, notwithstanding the agreement to submit their differences to the board of appraisers." *Delaware Underwriters vs. Brock*, 211 S.W. 779, 780-81 (1919).

Disinterested means without bias and prejudice as well as without pecuniary interest. *W.T. Waggoner Estate*, 39 S.W.2d at 595. As a result, those who repeatedly perform appraisals on behalf of the same party certainly call into question issues of bias and prejudice. In *Holt vs. State Farm Lloyds*, the insurer sought to enforce an appraisal award as an affirmative defense to Plaintiff's breach of contract and extracontractual claims. *Holt v. State Farm Lloyds*, 1999 WL 261923 (N.D. Tex. 1999) at p. 1. At issue was whether Tim Marshall of Haag Engineering who received approximately one quarter of his income from State Farm appraisal work was biased and/or prejudiced. *Id.* at p. 4. The District Court declined to grant State Farm's summary judgment given Plaintiff's evidence, finding a fact issue for the jury existed. *Id. Holt* is the one of the only cases which specifically addresses the issue, although the *W.T. Waggoner Estate* case includes a finding of a biased appraiser and umpire which invalidated an appraisal. *W.T. Waggoner Estate*, 39 S.W.2d 594. But see, *Gardner v. State Farm Lloyds*, 76 SW3d 140 (Tex. App. - Houston [1st Dist.] 2002, no pet) (no fact issue on summary judgment regarding independence of appraiser) and *Bunting v. State Farms Lloyds*, 2000 WL 191672 (N.D. Tex. 2000) (insufficient evidence to raise a fact issue regarding appraiser's independence).

W.T. Waggoner Estate does hold that the inadequacy of an award may be considered as a factor in evaluating bias and prejudice of an appraiser or umpire. *Id.* at 595. However, this factor alone is insufficient to establish bias and prejudice, and subsequent cases have not embraced *W.T. Waggoner Estate*. See, e.g., *Hennessey vs. Vanguard Ins. Co*., 895 S.W.2d 794, 798-799 (Tex. App. - Amarillo 1995, writ denied). However, in *May vs. Foremost Ins. Co*., 627 S.W. 2d 230, 233-234 (Tex. App. - San Antonio 1981, no writ), an appellate court denied enforcement of an appraisal award based on the insurer's summary judgment motion because of a continuing business relationship between the insurer and appraiser. The insurer was accused of acting in a concert with the appraiser in order to object to an umpire previously agreed upon. *Id.*

Other states address this issue differently. In Michigan, an appraiser who has been asked to participate as an appraiser by the same Plaintiff on an ongoing basis is not evidence of bias. *Northern Assurance Co. vs. Melinsky*, 213 N.W. 70, 71 (Mich. 1927). In contrast, prior relationships may be considered in *Pennsylvania Land vs. State Farm Mut. Ins. Co*., 600 A.2d 605, 607 (Pa. Super Ct. 1991). In California, an insurer must disclose any current dealings with an appraiser. *Gibers vs. State Farm General Ins. Co*., 45 Cal. Rptr. 2d 725, 728 (Ct. App. 1995).

Thus, the more appraisals and the more longstanding relationship between an appraiser and the selecting party, the more likely a finding of bias and prejudice will be found or at least create a fact issue to prevent enforcement of an appraisal award. Compare *Holt*, supra with *Gardner* and *Bunting*, supra.

Competency should also not be overlooked. An engineer is likely not competent as an appraiser for a silverware set, and a plumber probably will not suffice as an expert on roofing. Carefully examine every appraiser's competency or expertise in his/her appointment and subsequent award. If an appraiser is believed to be incompetent, a challenge to the award should be available to the party objecting to competency. See *E.I. Dupont de Nemours & Co., Inc. v. Robinson*, 923 SW2d 549 (Tex. 1995). In a summary judgment proceeding to enforce an appraisal decision, the appraiser's competency must be established as competency is mandated by the policy.

III. OTHER GROUNDS FOR AVOIDING AN APPRAISAL AWARD

Where issues of coverage, liability, and causation exist, counsel should seek to prevent an improper claim from going to appraisal. Overturning an appraisal award is a difficult task with the established bias in preserving the appraisal award. However, with the necessary evidence, appraisal awards can be set aside.

Case law provides three (3) basic instances where an appraisal award may be disregarded: (1) when the award was made without authority; (2) when the award was the result of fraud, accident, or mistake; and (3) when the award was not made in substantial compliance with the terms of the contract. *Providence Lloyds vs. Crystal City Indep. School Dist*., 877 S.W. 872, 875 (Tex. App. - San Antonio 1994, no writ); Hennessey, 895 S.W.2d at 798. All of these exceptions overlap each other. *Providence*, 877 S.W.2d at 878. Significantly, every reasonable presumption will be indulged in favor of an appraisal award. *Hennessey*, 895 S.W.2d at 798. However, in a summary judgment proceeding this presumption will not override summary judgment principles: that is all reasonable inferences will be indulged in favor of the nonmovant and the evidence will be viewed in the light most favorable to the nonmovant. *Mays*, 627 S.W.2d at 233-234; *Hennessey*, 895 S.W.2d at 798.

Several cases in Texas have addressed an appraisal award made without authority. Unless the appraisers disagree about the amount of loss, an umpire has no authority to sign an appraisal award. *Fisch vs. Transcontinental Ins. Co*., 356 S.W.2d 186, 189-190 (Tex. Civ. App. - Houston 1962, writ ref'd n.r.e.) In *Fisch*, the record was silent as to whether there were any differences between the two (2) appraisers. *Id.* at 189. The Court of Appeals reversed a directed verdict in favor of the insurer because there was no evidence of any disagreement between the appraisers and therefore any award signed by the umpire was without authority. *Id.* at 189-190. "An appraiser's acts in excess of the authority conferred upon him by the appraisal agreement is not binding on the parties." *Id.* at 190.

In Texas, *Wells vs. American States Preferred Ins. Co*., is a seminal case which provides an example of appraisers and umpires acting outside their authority. The Wells made a claim for foundation damage with their insurer, American States. *Wells*, 919 S.W.2d at 681. The insurer denied the claim, demanded appraisal, and then sued to enforce appraisal. *Id.* The Wells counterclaimed for breach of contract and other claims. *Id.* The trial court abated the counterclaims until appraisal was completed. *Id.* Two appraisers and an umpire determined the damage was $22,875.94 but one appraiser and an umpire determined the foundation damage was not caused by a plumbing leak. *Id.* The lack of a plumbing leak precluded coverage and the trial court entered summary judgment in favor of the insurer. *Id.* Before any lawsuit was filed, the parties disagreed on the cause of the foundation damage and consequently coverage. *Id.*

Setting aside the issues of waiver of appraisal by denying the claim and no evidence of any disagreement on amount by the appraisers, the Court of Appeals reversed summary judgment in favor of the insurer finding that the appraiser and umpire exceeded their authority in determining the amount of loss. "... [W]e conclude further that the appraisal section of the policy, as a matter of law, did not authorize and empower the appraisal panel to determine that the plumbing leak did not cause the loss to the Wells' property." *Id.* at 685. "... [W]e conclude

that the one appraiser and the umpire exceeded their authority when they determined that the plumbing leak did not cause the Wells' loss." *Id.*

In *Holt*, the District Court declined to grant the insurer summary judgment on enforcement of an appraisal award. *Holt*, 1999 WL 261923 at p.3. There, one appraiser and an umpire entered in award for $565 for wind damage to Holt's roof. *Id.* Yet, in the award was a statement: "No evidence of damaging hail in the form of splits of impacts that broke the wood shingles in the past nine (9) to twelve (12) months." *Id.* This statement was "an expression of damage causation. It was made without authority because it was outside the scope of the appraisal process..." *Id.*

The preceding cases illustrate an award made without authority. The appraisal award itself provided the necessary evidence to demonstrate lack of authority. However, there is no requirement that the evidence must come from the award itself, though the mental processes of the appraisers and umpire are likely insufficient to establish this factor. *Providence*, 877 S.W.2d at 878-879.

Appraisals which are a result of fraud, accident, and mistake can also be set aside or be made unenforceable. The most frequently cited case for this category is *Barnes vs. Western Alliance Ins. Co.*, 844 S.W.2d 264 (Tex. App. - Fort Worth 1992, writ dism'd by agr.) Barnes claimed roof hail damage to two (2) buildings he owned. *Id.* at 266. When Barnes and the insurer could not agree on the amount of loss, Barnes demanded appraisal. *Id.* at 267. An appraisal award signed by Barnes' chosen appraiser and the umpire was entered for $402,798.00. *Id.* The insurer neither challenged the award nor paid it forcing Barnes to file suit to enforce the award. *Id.* Following a trial, the jury awarded $67,834.89 and found that the award should be set aside for fraud, accident, or mistake. *Id.*

In the words of the Court of Appeals, the record "reveals numerous instances in which Barnes admitted in open court that he had previously lied about the hail damage to the roof and about the repair costs." *Id.* at 268-269. The evidence in addition to Barnes' own testimony was overwhelming in substantiating fraud. *Id.* at 270.

While the insured was the culprit in *Barnes*, an insurer can be equally guilty of fraud, accident, and mistake which will invalidate an appraisal award. In *Holt*, the District Court raised issues concerning the use of an independent and unbiased appraiser where the appraiser performed a substantial number of appraisals in favor of the appointing insurer. *Holt*, 1999 WL 261923 at pp. 3-4. In May, the insurer and the appraiser colluded on the appointment of an umpire and the appointed umpire had a prior employment relationship with the insurer. *May*, 627 S.W.2d at 234. The Texas Supreme Court reversed summary judgment in favor of the insurer and found a fact issue existed to preclude enforcement of the appraisal award. *Id.*

As previously noted, a gross disparity in an award versus repair cost is not by itself a basis to invalidate an appraisal award. *Hennessey*, 895 S.W.2d at 798-799.

The last category given to set aside an appraisal award is essentially a combination of the first two and anything else not in compliance with the policy. Obviously, appraisers and umpires determining causation, liability, and coverage are not in compliance with the policy; the same is true for an award based on fraud, accident, or mistake. An example falling perhaps outside the first two (2) categories is an appraisal where a disagreement exists over a partial loss versus a total loss. See *Glens Falls Ins. Co. v. Peters*, 386 S.W.2d 529, 532 (Tex. 1965). In Hennessey, the Court of Appeals reversed a summary judgment in favor of an insurer based on an appraisal award where the memorandum of appraisal and policy language conflicted. 895 S.W.2d at 801. Other areas of noncompliance with the policy include lack of a written demand for appraisal, delay in proceeding with appraisal, and issues regarding payment of appraisers and the umpire.

IV. THE *JOHNSON* CASE

On July 3, 2009, the Supreme Court of Texas altered the law regarding the proper scope of an appraisal when it issued its opinion in *State*

Farm Lloyds v. Johnson, 290 S.W.3d 886 (Tex. 2009). In the *Johnson* case, an April, 2003 hailstorm in Plano, Texas damaged the roof of Becky Ann Johnson's home, and she filed a claim under her homeowner's insurance policy with State Farm Lloyds. An inspector hired by State Farm concluded that only the ridgeline of Johnson's roof was damaged and estimated repair costs at $499.50. The policy had a $1,477 deductible. Johnson's roofing contractor, however, said the entire roof needed to be replaced at a cost of more than $13,000. Thus, a dispute arose over the extent of damages which were covered by the policy and those which were excluded from coverage. Thereafter, Johnson demanded appraisal of the damage to the roof in accordance with the terms of her policy. Refusing to participate in the appraisal, State Farm asserted that the dispute over the claim concerned causation and not the amount of loss. Johnson filed suit seeking only a declaratory judgment compelling appraisal. The trial court agreed with State Farm that no appraisal was warranted, but an appeals court reversed that decision. The case was appealed to the Supreme Court of Texas, which affirmed the decision of the court of appeals holding that appraisal was proper under the circumstances presented.

In arguing against appraisal, State Farm relied upon the principle that causation is not a proper issue for an appraisal. Surprisingly, the Court rejected this argument, holding that when different types of damage occur to different items of property, and appraisers may have to decide the damage caused by each before the courts can decide liability. The Court noted that appraisers consider causation in every case, at least as an initial matter. An appraisal is for damages caused by a specific occurrence, not every repair a home might need.

In support of its reasoning, the Court cited *Lundstrom v. United Servs. Auto. Ass'n-CIC*, 192 S.W.3d 78, 89 (Tex. App.--Houston [14th Dist.] 2006, pet. denied). In *Lundstrom*, appraisers assessed $ 4,226.19 for damages due to water (a covered peril) but made no finding for damages due to mold (coverage was disputed). The Texas Court of Appeals rejected the argument that appraisal is barred whenever causation factors into the award. The court affirmed the water damage award and rendered mold damage moot by finding no coverage. In this context, if courts could decide the amount of damage caused by each peril, there would be no damage questions left for the appraisers. The same would be true in Johnson's case, where the causation question involved separating loss due to a covered event from a property's pre-existing condition.

Thus, in certain situations, the Court appears to carve out an exception to the general rule that an appraisal should not involve decisions regarding causation or coverage. Even when certain elements of causation are at issue, the *Johnson* Court holds that appraisal should still take place, and the results will be sorted out later in the courts. Considering the long held precedent of limiting appraisal to the amount of loss, the effect of the Court's opinion in *Johnson* may be difficult to predict, and attacking an appraisal award as violative of *Johnson* will entail venturing into uncharted waters.