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An Impartial Appraisal Of Insurance Policy Requirements

Law360, New York (April 12, 2012, 2:21 PM ET) -- The U.S. District Court of the Southern District of Texas recently weighed in on the "impartiality" requirement for first-party property policy appraisers.[1] The insured sought to vacate an award based on past business relationships between the employers of a party appraiser and the umpire. The court held that such a relationship, without more, does not constitute bias.

The decision also examined whether an appraiser must necessarily retain outside experts to support its determination of loss, finding that it need not do so. Finally, the case offered insight into where to draw the line between a panel's permissible determination of the amount of loss, and impermissible determinations of questions of coverage.

Background Facts

Stateside Enterprises Inc. owned the Deerbrook Crossing Shopping Center in Texas.[2] In September of 2008, Stateside submitted a Hurricane Ike property damage claim to its commercial lines carrier, Massachusetts Bay Insurance Co. During adjustment of the Hurricane Ike claim, Stateside submitted a second claim for vandalism to rooftop heating, ventilation and air conditioning (HVAC) units at Deerbrook Crossing.

Massachusetts Bay tendered payment for both claims. Stateside was not satisfied with the amount offered. The policy at issue allows either party to demand appraisal if they "disagree[d] on the amount of loss." Stateside invoked the policy's appraisal provision.

The policy requires each party to select a "competent and impartial appraiser." The appraisers then jointly select an umpire, or if they cannot agree, a court chooses the umpire. The appraisal panel then determines the amount of loss through the following process:

> Each appraiser will state the amount of the loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding as to the amount of loss.

Stateside's appraiser recommended an umpire. Massachusetts Bay's appraiser agreed with the suggested umpire, and the appraisal panel was formed.

Massachusetts Bay originally tendered $219,529 for the hurricane claim and $50,000 for the vandalism claim. The appraisal panel, by agreement of the umpire and the Massachusetts Bay appraiser, awarded $784,311 for the hurricane loss and $185,815 for the vandalism claim.

Stateside Challenges the Appraisal Award in Court

Under Texas law, a valid appraisal award estops a party from litigating the amount of the loss. Stateside, seeking higher damages than awarded by the panel, filed suit to overturn the appraisal award's validity. Texas courts are required to indulge "every reasonable presumption" to sustain an appraisal award. The burden of proof falls to the party seeking to overturn the award, who must show that the award:

1. Did not comply with policy requirements;
2. Was made without authority; or
3. Resulted from fraud, accident or mistake.

Stateside raised each of these arguments in its lawsuit. Massachusetts Bay moved for summary judgment arguing that Stateside could not, as a matter of law, meet its burden of proof. The court's analysis of that motion touched on each of Stateside's arguments, as set out below:

The Appraisal Panel Met the Policy Requirement of Impartiality

The court focused on relationships between the employer of the insurer's appraiser and the employer of the umpire. Before the appraisal, the employer of the Massachusetts Bay appraiser, a national construction company, and the employer of the umpire, a national adjusting company, worked together on some of the same projects.

The adjusting company, on occasion, recommended that its clients hire the construction company. Stateside's appraiser also asserted — and the court accepted as true for purposes of the summary judgment ruling — that this relationship between employers was not disclosed before the appraisal, although the other panel members asserted that such a disclosure was made.

The parties agreed that while the Massachusetts Bay appraiser and the umpire met once before the appraisal, they neither worked together nor referred clients to one another personally.

Business Relations Between Employers Did Not Violate the Policy Requirement of Impartiality

Stateside argued that the employer-level business referral relationship — regardless of disclosure — violated the policy requirement of impartial appraisers.

The court disagreed. It ruled that the umpire and the Massachusetts Bay appraiser were not "biased" on the facts of this case. Pointing out that both employers were national companies — perhaps suggesting an expectation that companies of that size worked together in the past — the court held that a pre-existing relationship, without more, does not support finding of bias.

The court pointed out that record evidence did not show:

- Direct referrals between the individual appraiser and umpire;
- Massachusetts Bay "influencing or exercising control" over the umpire; or
- The umpire was more likely to side with Massachusetts Bay because of preexisting employer business relationships.

The Stateside court supported its ruling through comparison with two other cases concluding that employer-level business relationships do not establish bias.

The first case declined to overturn an appraisal on the basis of multiple paid engagements between the insurer and the employer of the insurer's appraiser.[3] In that case, the Texas court found no evidence that the insurer "influenced or exercised control" over its party appraiser, even though the appraiser's employer wrote training materials and consulted for the insurer on the same type of claim, and was paid by the insurer for assignments across the country over seven years.

The second decision pointed to by the Stateside court upheld an appraisal award where the insurer's appraiser was also the insurer's investigating engineer for the same claim.[4] That court observed that the engineer was not an employee of the insurer and his engineering report and conclusions were his own. No evidence showed that the insurer "influenced or exercised control" over the appraiser, that the appraiser had any financial interest in the claim, or that the appraiser's previous inspection factored into his damages analysis.

Finding that Stateside's evidence of bias was "certainly no stronger — if anything, it is significantly weaker" than these other two cases, the court declined to find that the business relationship between employers provided no basis to set aside the appraisal award.

Any Failure to Disclose the Employers' Business Relationships Was Not Grounds To Overturn the Appraisal

Stateside argued separately that the alleged failure by the umpire and the Massachusetts Bay appraiser to disclose their employers' business relationship created "an appearance of partiality" sufficient to avoid the award under Texas law.

The court found that appraisal-award cases, as opposed to arbitration cases, "control" this analysis. It observed that Stateside cited no cases in an appraisal context overturning an award based on a failure to disclose employer business relationships.[5]

Reiterating that where the business relationships themselves are not sufficient to overturn an appraisal, the court held that a failure to disclose such relationships also did not suffice to overturn an appraisal award. The court stated that overturning an appraisal would require "evidence that the challenged appraiser performed some act or conduct tending to exhibit his serving the insurer's interest as a partisan would."[6]

The Appraisal Award Did Not Result From Mistake or Accident

Stateside next sought to overturn the award by asserting that the appraiser for the insurer prepared estimates of damage that were not based on sound, reasonable or reliable appraisal methodology. As those estimates were then submitted to and considered by the umpire, Stateside argued that the award was the product of "mistake" or "accident."

Under Texas law, an appraisal award is set aside for mistake or accident only where the award does not speak the intent of the appraisers. Stateside provided no such evidence.

The court contrasted a case where misrepresentations during the appraisal process were shown to have confused the appraisal panel. In the Stateside case, to the contrary, the evidence showed the umpire simply decided to use the insurer's appraiser's estimates, not the insured's.

The Massachusetts Bay appraiser did not rely on outside expert or consultant reports; rather, he reached an estimate of loss based on his own knowledge and experience. Stateside's appraiser did obtain and rely on outside expert or consultant reports.

Stateside argued that the lack of consideration of outside experts showed that Massachusetts Bay appraiser's estimate was not based on sound, reasonable or reliable appraisal methodology. The court did not accept this argument. It pointed to record evidence that the insurer's appraiser was himself qualified to assess the scope and amount of loss, and declined to overturn the appraisal award.

Resolving Questions of Coverage May Exceed Appraiser Authority

The insured also argued that the appraisal panel exceeded its authority by resolving coverage questions as to multiple items of damage. In addressing these issues, the court provided an analysis of its view of Texas law on the interplay between questions of causation and determining the amount of loss is examined below.

The court began with the adage that damage questions are for appraisers, and liability questions are for the courts. Texas courts recognize, however, that this distinction can become complicated in practice.

As explained by the court, an appraisal panel might not be treading impermissibly into liability questions just because some causation questions factor into an appraisal award. Whether causation is an allowable damages inquiry, or a prohibited liability inquiry, will depend on the particular circumstances.

The court observed that where parties allege different causes of loss for a single injury to property, that is often a liability question — the panel can decide on a cost to repair, but ought not decide whether that cost is covered. The court also noted that where different types of damage occur to different items of property, a panel may need to assign a value to each type of damage and await a liability determination.

The court summed up as follows:

> "Ultimately, 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."[7]

As examples of these principles applied to certain elements of the appraisal award at issue, the court concluded that the panel properly determined the amount of loss to a roof, even where that assessment included separating loss due to a covered event from a pre-existing condition.

The court also upheld the panel's determination of the extent of damage to a concrete masonry unit wall from the hurricane where the entire panel agreed the hurricane damaged the wall, but did not agree as to the extent of damage.

Conclusion

Decisions regarding the validity of appraisal awards are necessarily fact-intensive. They depend on specifics of the claim and the law of a particular jurisdiction. Jurisdictions vary in how they evaluate issues of impartiality and the permissible scope of appraisal.

Still, this case suggests a few questions that parties entering into appraisal might wish to consider.

For example, would requesting early written disclosure by the panel of all business relationships, including those of the panel's employers, have reduced the chance of a contest following the appraisal award? Is complete disclosure practical or possible in all cases? Are there steps counsel can take in advance of appraisal to guide the panel on how to comply with issues of scope that might arise under the law or facts of a particular claim?

The court's ruling in this case provides some guidance, but leaves other questions open for a later date.

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[1] MLCSV10 v. Stateside Enterprises, Inc., Consol Plaintiff, v. Hartford Steam Boiler Insp. and Insur. Co, et al., No. H-10-4186, S. D. Tx. (March 30, 2012) available at 2012 U.S. Dist. Lexis 44790.

[2] During the appraisal, Stateside sold its interest in Deerfield Crossing to an entity called MLCSV10. That sale included rights to all "policy based claims" from the hurricane and vandalism claims. The sale did not impact the issues discussed within. For simplicity the insured is referred to as Stateside.

[3] Citing Gardner v. State Farm Lloyds, 76 S.W.3d 140 (Tex. App. 2002) (citations omitted).

[4] Citing Franco v. Slavonic Mut. Fire Ins. Ass'n., 154 S.W.3d 777, 785 (Tex. App. 2004).

[5] The court also analyzed the impartiality issue under arbitration law, and reached the same conclusion. MLCSV10 at **21-23.

[6] MLCSV10, 2012 U.S. Dist. Lexis 44790 at *20 (citations and quotations omitted).

[7] Id. at *28-29.