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More Coverage Issues May Go To Appraisal Panels In Minn.

Law360, New York (January 23, 2015, 5:26 PM ET) --
Most property insurance policies contain a provision that allows either the insurer or the insured to demand appraisal when the parties fail to agree on the "amount of loss." Appraisal provisions generally require each party to select an appraiser who then selects a competent and disinterested umpire. Together, the appraisal panel determines the amount of the insured's loss.


Scott G. Johnson

Courts generally recognize that appraisal panels measure the amount of a loss and do not determine coverage or interpret the insurance policy.[1] But in Cedar Bluff Townhouse Condominium Association v. American Family Mutual Insurance Co., A13-0124, 2014 Minn. LEXIS 661 (Minn. Dec. 17, 2014), the Minnesota Supreme Court ruled that an appraisal panel could interpret valuation provisions in the insurance policy and determine issues of coverage subject to later judicial review. At issue there was a loss payment provision in the policy that specified that replacement cost be determined based on the cost to replace the damaged property with other property "of comparable material and quality." The court in Cedar Bluff upheld an appraisal panel's determination this provision required that all of the siding on 20 condominium buildings had to be replaced when some of the siding was damaged because it was the only way to provide a color match.

Underlying Facts

In Cedar Bluff, the insured condominium association consisted of 20 multiunit residential buildings. The exterior of each building consisted of a series of siding panels. Each siding panel was approximately 15 square feet in size.

During a hail storm in October 2011, all 20 buildings sustained some siding damage. There were three or fewer damaged siding panels on 11 of the 20 buildings. The building with the most damage had 10 damaged panels, and the building with the least damage had only one damaged panel. At the time of the storm, the siding panels were 11 years old and had faded to some extent. Replacement panels were available from the original siding manufacturer, but the panels were not available in the same color.

Cedar Bluff submitted a claim to its insurer, American Family, for the hail damage. The American Family policy provided that the insurer would pay for the cost to repair or replace the damaged property. The policy stated that replacement cost was to be determined based on the cost to replace the damaged

property with other property “of comparable material and quality.”

A dispute arose between Cedar Bluff and American Family as to the extent of repairs or replacement. Specifically, American Family proposed replacing only the damaged siding panels. It took the position that the policy only required replacement of the siding panels that were actually damaged. As noted previously, the manufacturer no longer carried the siding in the original color. This resulted in American Family choosing a color from the same manufacturer that was “slightly darker or slightly lighter” than the original siding. Cedar Bluff, however, demanded that the insurer replace all of the siding panels on all 20 of the buildings. Cedar Bluff contended that all of the siding panels had to be replaced because there would be a “color mismatch” with the existing siding panels if only the damaged panels had to be replaced. Cedar Bluff asserted that the phrase “of comparable material and quality” required a color match between the damaged and the undamaged siding panels. The cost of replacing all of the siding panels ($361,108) was substantially higher than the cost of replacing only the damaged siding panels ($6,800).

Because the parties were unable to agree on the amount of the loss, Cedar Bluff demanded appraisal in accordance with the policy’s appraisal provision. After a hearing which involved a presentation of evidence and a site visit, the appraisal panel found that while the original siding panels could be replaced with panels from the original manufacturer, the siding panels “could not be matched in terms of color.” Based on the color difference, the appraisal panel concluded that “there was not a reasonable match available for the existing siding materials.” The panel then issued an appraisal award for “a total replacement of the siding.” The total cost was $361,108. The appraisal panel acknowledged that American Family’s position “would be correct if the subject policy did not require such a color match,” but that a color mismatch was “not a repair or replacement with comparable materials of like kind and quality.”

American Family refused to pay the appraisal award because it believed that the award was based on the panel’s unauthorized coverage determination. Therefore, Cedar Bluff filed suit seeking confirmation of the appraisal award. American Family counterclaimed, alleging that the appraisal panel exceeded its authority when it interpreted the insurance policy.

The trial court granted American Family’s motion for summary judgment, ruling that American Family was not required to pay for the cost to replace siding panels that were not damaged. Additionally, the trial court found that American Family was not required to pay for siding that was an exact color match to the original siding because the term “color match” was not in the policy.

On appeal, the Minnesota Court of Appeals, the state’s intermediate appellate court, reversed.[2] That court found that under the Minnesota Supreme Court’s decision in Quade v. Secura Insurance Co., 814 N.W.2d 703 (Minn. 2012), the appraisal panel had had the authority to consider the meaning of the phrase “of comparable material and quality” in the policy’s loss valuation provision when determining the amount of loss. The Minnesota Supreme Court subsequently granted review.

The Court’s Rationale

The Minnesota Supreme Court affirmed the court of appeals and the appraisal panel’s award, holding that, under the terms of its insurance policy with American Family, Cedar Bluff was entitled to have all of the siding panels on each of its 20 buildings replaced.

The court acknowledged that the interpretation of an insurance policy is a question of law and that an

appraisal panel may not construe the insurance policy. But the court, relying on its earlier decision in Quade v. Secura Insurance Co., 814 N.W.2d 703 (Minn. 2012), noted that questions of law, such as policy interpretation, which are involved as "mere incidents to a determination of the amount of loss or damage," are appropriately resolved by an appraisal to determine the amount of loss.

Thus, the court held that, subject to judicial review, the appraisal panel had the authority to consider the meaning of policy terms in order to determine the amount of Cedar Bluff's loss. The court further held that the trial court had erred by refusing to accept the factual determinations of the appraisal award (that is, that matching replacement siding panels were not available).

The court noted that although this is an appeal from a grant of summary judgment, the court granted review to determine if the appraisal panel properly concluded that American Family's obligation to replace damaged property with property of comparable material and quality required it to replace damaged and undamaged property to achieve a color match. This required the court to interpret the provisions of the insurance policy de novo.

To that end, the court observed that the insurance policy must be construed as a whole, beginning with the plain and ordinary meaning of the policy's terms, as well as "what a reasonable person in the position of the insured would have understood the words to mean."[3]

Relying on the dictionary definition of "comparable," the court concluded that "the plain meaning of the phrase 'comparable material and quality' is material that is suitable for matching." It further concluded that "on the spectrum of resemblance, 'comparable material and quality' requires something less than an identical color match, but a reasonable color match nonetheless." Therefore, the court construed the phrase "comparable material and quality" to mean "a reasonable color match between new and existing siding when replacing damaged siding."

The court then turned to the question of whether the appraisal panel properly interpreted "comparable material and quality" to require an exact color match or merely a reasonable color match. The court concluded that it was the former based on the panel's use of the words "reasonable match" in the appraisal award. Accordingly, the court concluded that the appraisal panel applied the correct legal standard.

Having concluded that the appraisal panel applied the correct legal standard, the court turned to the question of what property must be replaced. Here, the court stated that "the question to be answered is whether the color mismatch constitutes 'direct physical loss of or damage to Covered Property.'" The court concluded that "[b]ecause of the color mismatch resulting from the inability to replace the hail-damaged siding panels with siding of 'comparable material and quality,' the covered property — Cedar Bluff's 'buildings' — has sustained a 'distinct, demonstrable, and physical alteration.'" Thus, the court concluded that the covered property sustained a covered loss. As a result of the dispute between Cedar Bluff and American Family, the appraisal panel was selected to determine the amount of loss. The court noted that the appraisal panel held a hearing at which it considered all of the evidence, heard from witnesses and examined the damaged property in person. Because there is a strong public policy in Minnesota favoring appraisals, the court deferred to the appraisal panel's factual determination as to the amount of loss.

Finally, the court noted that its opinion was limited to the case before it. It noted that all storm-related property damage claims involve their own unique facts. It observed that "[i]n this particular case, the spot damage to multiple siding panels on multiple buildings, along with the appraisal panel's assessment

of the particular color mismatch, applied to the policy language at issue, lead to our conclusion that there is coverage."

Analysis

Appraisals determine only the monetary amount of the insured's loss or damage, that is, the actual cash value or replacement cost of the claimed loss. Appraisals are not designed to resolve issues of coverage or policy interpretation. But courts have found that the line between liability and measurement issues is not always clear. Thus, some courts, including the Quade case upon which the Cedar Bluff court relied, have found that determining the amount of loss under an insurance policy necessarily includes a determination of causation.[4] Other courts have found that an appraisal panel can determine what repairs are necessary as a result of the loss.[5]

But the court in Cedar Bluff went one step further when it found that an appraisal panel could interpret policy provisions that are "mere incidents to a determination of the amount of loss or damage," subject to later judicial review. The court put valuation provisions in this category, specifically a loss payment provision that specified that replacement cost be determined based on the cost to replace the damaged property with other property "of comparable material and quality."

To avoid having an appraisal panel decide issues of coverage (subject to later judicial review), parties need to resolve coverage issues before submitting disputes to appraisal. In some cases, as in Cedar Bluff, appraisal may be demanded before any suit was filed. If in those instances a party believes that there are coverage issues, that party could file suit and subsequently move to stay appraisal pending resolution of coverage issues. Courts in other jurisdictions have deferred appraisal until resolution of coverage issues. In Kirkwood v. California State Automobile Association Inter-Insurance Bureau, 122 Cal. Rptr. 3d 480, 490 (Cal. Ct. App. 2011), for example, the court said that "judicial economy favors resort to declaratory relief" as to questions of coverage prior to appraisal because it "head[s] off duplicative future actions" challenging policy interpretation.

Finally, the law on appraisal varies by jurisdiction. Thus, practitioners should review the applicable governing law for guidance on these issues.

—By Scott G. Johnson, Robins Kaplan LLP

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[1] See, e.g., Kirkwood v. Cal. State Auto. Ass'n Inter-Ins. Bureau, 122 Cal. Rptr. 3d 480, 482, 489 (Cal. Ct. App. 2011); Johnson v. Nationwide Mut. Ins. Co., 828 So. 2d 1021, 1025 (Fla. 2002); see generally Ashley Smith, Property Insurance Appraisal: Is Determining Causation Essential to Evaluating the Amount of Loss, 2012 J. DISP. RESOL. 591, 594.

[2] Cedar Bluff Townhouse Condo. Ass'n v. Am. Family Mut. Ins. Co., No. A13-0124, 2013 Minn. App. Unpub. LEXIS 1063 (Minn. Ct. App. Dec. 2, 2013).

[3] Cedar Bluff Townhouse Condo. Ass'n v. Am. Family Mut. Ins. Co., A13-0124, 2014 Minn. LEXIS 661 (Minn. Dec. 17, 2014) (quoting Midwest Family Mut. Ins. Co. v. Wolters, 831 N.W.2d 628, 636 (Minn. 2013)).

[4] See, e.g., Quade v. Secura Insurance Co., 814 N.W.2d 703, 706-07 (Minn. 2012); State Farm Lloyds v. Johnson, 290 S.W.3d 890, 891-93 (Tex. 2009). For example, the Quade case involved a dispute over whether damage to the insured's roof was caused by wind (covered) or wear and tear (excluded). The court held that a determination of the "amount of loss" under the appraisal clause necessarily included a determination of causation. Quade, 814 N.W.2d at 706-07.

[5] Currie v. State Farm Fire & Cas. Co., No. 13-6713, 2014 U.S. Dist. LEXIS 117970, at *12 (E.D. Pa. Aug. 19, 2014).