AN UPDATE ON APPRAISAL: WHAT THE HECK HAPPENED?

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Just a few years ago, the law on appraisal seemed relatively settled. Appraisal was viewed as an efficient method to determine amount of loss in most property policies. It could not be used in every case; when causation, coverage, and liability were at issue, its use was improper. There was no flood of appraisal cases and the clause as interpreted by the Texas courts seemed to be working fine. And then the Supreme Court of Texas decided to tinker with the appraisal clause. The result was *State Farm Lloyds v. Johnson* which seemed to do the opposite of clarifying appraisal. 290 SW3d 886 (Tex. 2009). The Court then followed two years later with *In re Universal Underwriters*, 345 S.W.3d 404 (Tex. 2011).

A. THE GOOD OLD DAYS

Texas courts for over one hundred (100) years had been rather consistent in interpreting appraisal clauses, although how an appraisal was used is another story. Appraisal is to be used to provide a simple, speedy, inexpensive, and fair method of determining the amount of loss only. *Fire Ass'n v. Ballard*, 112 S.W.2d 532, 534 (Tex. Civ. App. – Waco 1938, no writ). Appraisal is *not* arbitration. *In Re Allstate Ins. Co.*, 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 insured. *Scottish Union National Ins. Co. v. Clancy*, 71 Tex. 5, 8 S.W. 630, 631 (1888). Appraisal may be waived. *Ins. Service Co. v. Brodie*, 337 S.W.2d 414, 415 (Tex. Civ. App. – Fort Worth 1960, writ ref'd n.r.e.) (or at least we thought so). Appraisers and umpires are without authority or power in an appraisal to determine "questions of causation, coverage, or liability … ." *Wells v. American States Preferred Ins. Co.*, 919 S.W.2d 679, 684 (Tex. App. – Dallas 1996, writ denied).

The parties to appraisal are required to choose competent and disinterested appraisers. *General 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.). An appraiser who has a financial interest in an appraisal award is not impartial. *Id.* An appraiser or umpire does not represent any party's interests or views and is to act in a quasi judicial capacity. *Pennsylvania Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm'n App. 1931, no writ). The use of an umpire and/or his signing of an award is unnecessary absent an actual disagreement about the amount of loss between the appraisers. *Fisch v. Transcontinental Ins. Co.*, 356 S.W.2d 186, 189-190 (Tex Civ.App. – Houston 1962, writ ref'd n.r.e.).

Every reasonable presumption will be indulged in favor of an appraisal award. *Hennessey v. Vanguard Ins. Co.*, 895 S.W.2d 794, 798 (Tex. App. – Amarillo 1995, writ denied). Nevertheless, an appraisal award may be disregarded in three (3) instances: 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 v. Crystal City Indep. School Dist.*, 877 S.W.2d 872, 875 (Tex. App. – San Antonio 1994, no writ); *Hennessey*, 895 S.W.2d at 798.

The status of appraisal law appeared predictable and settled until the Texas Supreme Court's decisions in *Johnson* and *Universal Underwriters*.

B. THE HISTORY OF JOHNSON PRIOR TO THE TEXAS SUPREME COURT

In April 2003, Becky Ann Johnson's ("Johnson") house was damaged by hail. *Johnson v. State Farm Lloyds*, 204 S.W.3d 897, 898 (Tex. App. – Dallas 2006, pet.

granted). State Farm Lloyds ("State Farm") inspected Johnson's property, specifically the roof, and concluded only the ridgeline of Johnson's roof was damaged by hail, estimating the loss at $499.50 which was less than Johnson's deductible. *Id.*

Johnson requested a second inspection, but State Farm's conclusion remained the same. *Id.* Johnson did not accept State Farm's determination and contended the entire roof needed to be replaced, submitting an estimate for $6,400. *Id.* Johnson hired a lawyer who demanded appraisal. *Id.*

The appraisal clause in Johnson's policy provides:

> **SECTION I-CONDITIONS**
> ***
> **4. Appraisal.** If you and we fail to agree on the *amount of loss*, either one can demand that the amount of the loss be set by appraisal. If either makes a written demand for appraisal, each shall select a competent, disinterested appraiser. Each shall notify the other of the appraiser's identity within 20 days of receipt of the written demand. The two appraisers shall then select a competent, impartial umpire. If the two appraisers are unable to agree upon an umpire within 15 days, you or we can ask a judge of a court of record in the state where the **residence premises** is located to select an umpire**.** The appraisers shall then set the amount of the loss. If the appraisers submit a written report of an agreement to us, the amount agreed upon shall be the amount of the loss. If the appraisers fail to agree within a reasonable time, they shall submit their differences to the umpire. Written agreement signed by any two of these three shall set the amount of the loss. Each appraiser shall be paid by the party selecting that appraiser. Other expenses of the appraisal and the compensation of the umpire shall be paid equally by you and us.

Id. at 900. Emphasis added.

State Farm responded that the dispute was about coverage; therefore, appraisal was not proper or appropriate. *Id.* Johnson filed a declaratory judgment to compel appraisal. *Id.* at 898-899. Both parties moved for summary judgment. *Id.* The trial court granted State Farm's summary judgment motion and Johnson appealed. *Id.* at 899.

The Dallas Court of Appeals reversed, finding Johnson was entitled to appraisal. *Id.* at 899. The Dallas Court of Appeals framed the issue this way:

> This case involves the determination of whether the meaning of the term "amount of loss" in an appraisal clause of a homeowner's insurance policy includes the *extent* of loss and whether the insured can compel the insurer to appraisal when there is a dispute about the extent of loss.

Id. at 898. Emphasis added.

Johnson argued that the amount of loss includes a dispute over the extent of the damage. *Id.* at 900. In contrast, State Farm argued that no appraisal can be compelled unless the parties agree on causation, coverage, and liability. *Id.* In particular, State Farm took the position that because it only acknowledged coverage on the ridgeline and the remainder of the roof was damaged by an excluded cause – wear and tear - the issue was coverage, not the amount of loss. *Id.* at 901. Therefore, State Farm argued the amount of loss does not include the *extent of loss*, because it would necessarily include determining coverage, causation, and/or liability.

In evaluating both parties arguments, the Dallas Court of Appeals cited *Wells,* which it had decided ten (10) years earlier, and wrote that it stood for the proposition that appraisers and umpires do not determine coverage. *Id.* at 902. Instead, the Court of Appeals wrote that under *Wells*, appraisers are to determine the "amount of damage" resulting to the property submitted for their consideration. *Id.* citing *Wells*, 919 S.W.2d at 685.

According to the Dallas Court, the parties in *Wells* agreed "on the extent of the loss and cost of repairs, but disagreed on whether there was a covered loss at all." *Johnson*, 204 S.W.2d at 902. And the appraisers in *Wells*, according to the *Johnson* Court, used appraisal to determine if the loss was caused by a covered peril. *Id.*

The Court distinguished *Wells* from *Johnson* by asserting that the parties in *Johnson* agreed there was a covered loss, but disagreed on the extent of the loss and cost of repairs. *Id.*

The Dallas Court of Appeals also cited *Lundstrom v. United Services Automobile Ass'n*, 192 S.W.3d 78 (Tex. App. – Houston [14th Dist.] 2006, pet. denied) as being similar to the issues in *Johnson* by noting the appraisers in *Lundstrom* had to determine which damages were caused by one water leak, which was covered by the policy, versus damages occurring at another time, which were not covered. *Johnson*, 204 S.W.2d at 920. Based on the Dallas Court of Appeals reading of *Lundstrom*, both cases stood for the "narrow proposition that appraisers exceed their authority when they make legal determinations of what is or is not a covered loss based on their determination of what caused the loss or some portion of it." *Id.* at 902-903. Thus, appraisers "making decisions about the extent of damage" is not precluded by *Wells* or *Lundstrom*. *Id.* The rule then is 'if the parties agree there is coverage, but disagree on the extent of damage, the dispute concerns the 'amount of loss' and that issue can be determined in accordance with the appraisal clause." *Id.* at 903.

In very simple terms *Johnson* holds that the amount of loss *includes* the extent of loss. Therefore, applying the rationale of *Johnson*, if there is damage to an automobile caused by hail on a very small part of the car and other parts are allegedly suffering from rust, a noncovered peril, appraisal would be appropriate to decide the extent of the covered loss. Sound confusing? It is.

A review of the standard appraisal clause substantiates that the term *extent of loss* is not found. Reading this term into appraisal clause only confuses the appraiser's task and obligations and makes it

unclear for the insurer and insured to decide when appraisal is proper. Including "extent" into appraisal determinations translates into how much is damaged and *what caused it*, rather than how much does it cost to repair or replace.

Under the Dallas Court of Appeals' *Johnson* opinion, once the parties agree there is some coverage for a loss, but disagree how much of the loss is actually covered, the extent of loss can be decided by appraisers. Nevertheless, it would appear obvious that the task of the appraisers in such a situation is to decide *how much of a covered loss exists*; logically, this task would entail an appraiser making a decision on causation – whether the damage was caused by hail as opposed to rust – wear and tear – or both hail and rust – concurrent causation. Hence, the actual effect is appraisers in such cases would be permitted to make causation determinations leading to coverage and liability which is contrary to *Wells.*

The consequences of Dallas Court of Appeals' opinion in *Johnson* would be an appraisal award where the extent of damage was decided would be binding on the parties even where the causation (covered vs. noncovered) was also at issue. Logically then, decisions regarding causation, and ultimately coverage, could be decided by appraisal – trial by appraisal through the use of appraisers and in the *Johnson* case – trial by roofer.

It would seem insurers would be in the best position to take advantage of *Johnson*, yet it was State Farm who sought review in the Texas Supreme Court contending where issues of causation, and ultimately coverage and liability, are being decided, then appraisal is not appropriate. Overall, State Farm contended in this situation that appraisal had no value as an efficient and inexpensive method to

determine the amount of loss because it could not be binding. *State Farm Lloyds v. Johnson*, 290 S.W.3d at 887-888.

C. *STATE FARM LLOYDS V. JOHNSON* IN THE SUPREME COURT OF TEXAS

The Texas Supreme Court accepted State Farm Lloyds' petition for review to decide whether the dispute between Johnson and State Farm fell within the scope of the appraisal clause. *Id*. at 888. Against most appellate odds (considering that acceptance of review usually translates into reversal), the Court affirmed the Dallas Court of Appeals. *Id.* at 887. Hinting that its affirmance was a pro-consumer decision, the Court wrote: "… we affirm the court of appeals' judgment *in favor of the insured*." *Id.* Emphasis added. There were no dissents. This decision, though, can hardly be termed a pro policyholder decision.

The Court at the outset noted it had infrequently written about appraisal. *Id.* at 888. From that logic, the Court then concluded appraisal must be working well, so why limit it. *Id.* at 888-889.

The Court framed the issue before it as follows: "whether the dispute … fell within the scope of the appraisal clause." *Id.* at 888. In beginning its opinion, the Court held that trial courts have no discretion to ignore a valid appraisal provision *entirely*. *Id.*

The Court began its opinion by attempting to trace the history of appraisal clauses. *Id.* The Court concluded appraisal clauses are enforceable and used to determine *the amount of loss for a covered claim*, *Id.* But the Court pointed out it had not resolved a dispute about the scope of appraisal, more particularly the meaning of "amount of loss." *Id*. at 888-889. The Court did note an appraisal clause instructs the appraisers to decide the "amount of loss," but not decide policy construction or whether the claim should be paid. *Id.* at

889-890. Again reasoning that because of the "scarcity of suits" on appraisal, the focus is on damages as opposed to liability and suggested appraisal provisions were working. *Id.* at 890. Despite these observations, the Court then embarked a mission of expanding appraisal employing inconsistent reasoning which has resulted in appraisal being used to decide, at least implicitly, coverage, causation and/or liability.

In evaluating State Farm's appeal, this state's highest civil court wrote that the Texas courts *have split on the question of whether appraisers can decide causation.* *Id.* at 890-891. In making this statement, the Court in a footnote cited one case allegedly supporting appraisers determining causation and four (4) cases that prohibit it. *Id.* at 890-891, n. 24. In making this conclusion, the Court did not discuss its implicit approval of *Wells* by denying review of the Dallas Court of Appeals' decision almost fourteen (14) years previous to *Johnson*. *Wells* explicitly prohibited appraisers deciding causation. *Wells*, 919 S.W.2d at 684.

But the Court did decide that the facts in *Johnson on the record presented to it* did not prove the dispute was about causation. *Id.* at 891. The Court reasoned: because State Farm acknowledged some shingles were damaged by hail, a covered peril, the dispute surrounded how many shingles were damaged; "A dispute about how many shingles were damaged and needed replacing is surely a question for the appraisers." *Id.*

To support this conclusion, the Court asserted that the cost of replacing shingles "is a function of both *price* and *number* … " *Id.* (emphasis in the original). Which shingles need replacing is a dispute for appraisal. *Id.* To the extent the parties disagree which shingles need replacing, that dispute would fall within the scope of appraisal. *Id.* See a problem?

According to the Court, nothing in the summary judgment record revealed that the shingles were damaged by anything but hail. *Id.* Because there was no contrary evidence in the record about covered versus noncovered causes (according to the Court), the trial court could not deny appraisal as a matter of law simply because State Farm contended the dispute was about causation. *Id.* Additionally, the summary judgment record did not show the dispute was *solely* about how much of Johnson's roof was damaged. *Id.* Thus, because this was a summary judgment proceeding, the trial court erred when it decided the dispute was about causation. *Id.*

Justice Brister then wrote "Even if the parties' dispute involves causation, that does did not prove whether it is a question of liability or damages". *Id.* at 891. Reasoning further, the Court determined that causation relates to both liability and damages because it is the connection between them." *Id.* at 891-892. To justify this contention, the Court referred to the *Texas Pattern Jury Charges* which placed causation in both liability and damage categories. *Id.* at 892. Abstractively, the Court wrote that causation could fall equally into both categories – liability and damages. *Id.*

To arrive at this conclusion, the Court cited *Wells* and *Lundstrom*, *Wells* where the appraisers determined damages based on two causes, one covered peril versus another noncovered peril, and *Lundstrom* where appraisers allegedly did the same thing. *Id.* at 892. The Court held that both decisions were correct because courts determine coverage and appraisers decide the amount of damage caused by each peril. *Id.* This principle also is applicable in evaluating a loss due to a covered event versus a preexisting condition. *Id.* According to the Court, to hold otherwise would mean that appraisers could never evaluate hail damage unless the

roof was brand new, making an appraisal clause invalid, a construction which the Court must avoid. *Id.* at 892-893. To property insurance practitioners, this was a departure from precedent.

The Court further stated that appraisers "must always consider causation, at least as an initial matter. An appraisal is for damages caused by a specific occurrence, not every repair a home might need." *Id.* at 893. Therefore, appraisal necessarily must include some causation because the appraisers have to decide damages where coverage is claimed versus damages to other property caused by something else. *Id.*

Attempting to provide some comfort, the Court held that State Farm does not have to pay for wear and tear or other excluded perils. *Id.* If the appraisers go beyond damage questions, then the award may be avoided, but the mere existence of a causation question is not enough. *Id.*

The Court further opined that even if appraisal does involve liability questions, it should not be prohibited initially. *Id.* at 894. In making this statement, the Court provided four (4) reasons. *Id.* First, appraisals that have yet to occur involve conditions precedent and allowing litigation preappraisal would encourage more litigation, thereby defeating the purpose of appraisal. *Id.* Second, appraisals that have yet to occur can be structured to avoid liability questions; even if the insurer denies coverage, there is no harm in an appraiser setting the amount of loss. *Id.* Third, the lack of precedent on scope of appraisal suggests that appraisal generally resolves such disputes. *Id.* at 894-895. Fourth, a flawed appraisal can be disregarded. *Id.* at 895. Based on this reasoning, the Court held that appraisal should occur prelitigation and not involve the legal process, such as lawyers, judges, discovery, motions, and hearings. *Id.* at 894-895. Appraisals should

proceed without "preemptive intervention by the Courts." *Id.* at 895.

Yet, *Johnson* does a disservice to insurers and insureds. Instead of limiting the reasoning in *Johnson* to the facts in the summary judgment record, the Texas Supreme Court went far beyond the facts to permit futile exercises which needlessly complicate and increase the cost of a claim and ultimately litigation.

State Farm petitioned for rehearing which was denied. In its *Motion for Rehearing*, State Farm tried to draw the Court's attention that its decision confused more than helped, created needless and wasted efforts, increased the costs to all parties to an appraisal, complicated litigation about a claim, pointed out that an appraisable issue plus an unappraisable issue does not equal an appraisable issue, and the Court's reasoning was rewriting the policy. *See Petitioner's Motion for Rehearing*. Based on prior decisions and practical application, State Farm's arguments are persuasive and have a great deal of merit. Rehearing was nevertheless denied.

D. UNIVERSAL UNDERWRITERS

Insureds who did not like *Johnson* changed their strategy to avoid appraisal by arguing insurers waived their rights to appraisals. The strategy was dealt a near fatal blow by the Supreme Court of Texas in its recent opinion: *In re Universal Underwriters*, 345 S.W.3d 404 (Tex. 2011).

The facts in *Universal Underwriters* were not complicated: Universal insured Grubbs Infiniti. *Id*. at 405. Grubbs' buildings suffered hail damage. *Id*. at 406. Universal paid Grubbs $4,081.95 for the loss. *Id*. Grubbs was dissatisfied with the amount and asked Universal to reevaluate. *Id*. Universal responded by sending an engineer to reinspect; the engineer found $3,000.00 in damages and Universal paid this amount. *Id*.

Universal sent the $3,000.00 payment with a letter advising Grubbs that the insurer would hold open its file for another fifteen (15) days. *Id*. Furthermore, Universal reminded Grubbs that it had two years and one day to file suit pursuant to Grubbs' insurance policy with Universal. *Id*.

Four months after receiving the $3,000.00 payment, Grubbs sued Universal. In response, Universal invoked the appraisal clause. *Id*.

Universal filed a motion to compel appraisal which the trial court denied. *Id*. Universal then sought mandamus relief in the Court of Appeals which was also denied. *Id*. Universal then sought mandamus relief in Texas Supreme Court and received a warm reception. *Id*.

Chief Justice Jefferson, writing for the Court, began by discussing previous high court decisions on waiver of appraisal, noting of three cases addressing the issue, one of the three decisions found waiver. *Id*. at 407 citing *Delaware Underwriters v. Br*ock, 109 Tex. 425, 211 S.W 779, 780-781 (1919). *Brock* dealt with waiver due to insurer's selection of a biased appraiser in violation of the insurance policy. *Id*.

Chief Justice Jefferson noted that the eight month delay between the last payment and Universal's letter to Grubbs and Universal's demand for appraisal was not waiver based on a number of Court of Appeals decisions finding waiver. *Universal Underwriters*, 345 S.W.3d at 406-407. Rather, decisions involving 39, 58, or 72 day delays before requesting appraisal were not decided on the lengths of delay but "rather on the parties' conduct, as indications of waiver". *Id*. at 408. The Court noted that "waiver requires intent, either the intentional relinquishment of a known right or intentional conduct inconsistent with claiming that right." *Id*. citing *In re General Electric Corp*., 203

S.W.3d 314, 316 (Tex. 2006). Thus, the Court held that time periods alone are not determinative of waiver, only a factor. *Id*.

The Court then announced a new two (2) part test, one, of which, by the Court's own admission, can never be satisfied. First, any delay for purposes of waiver must be measured from the point of "impasse". *Id*. at 408. "Impasse" is defined as when both sides realize that further negotiations would be futile or have no further effect. *Id*. at 409. Stated simply: "Once the parties have reached an impasse – that is, a neutral understanding that neither will negotiate further – appraisal must be invoked within a reasonable time." *Id*. Because Universal invoked appraisal one (1) month after Grubbs sued, Universal demanded appraisal within a reasonable time. *Id*.

The second part of the test announced in *Universal Underwriters* is prejudice: a party must show that it has been prejudiced to avoid appraisal based on waiver. *Id*. at 411. The prejudice requirement has been invoked in other insurance contexts such as policy provisions requiring notice to the insurer "as soon as practicable". *Id*. citing *Prodigy Communications Corp. v. Agricultural Excess & Surplus Ins. Co*., 288 S.W.3d 374, 382 (Tex. 2009). The Court noted that "it is difficult to see how prejudice could ever be shown when the policy . . . gives both sides the same opportunity to demand appraisal". *Id*. at 412. Thus, the Court has announced a test no party can satisfy.

To summarize, to establish waiver of the appraisal clause, a party must show an actual impasse existed and an unreasonable period of time passed following the actual impasse. And even if an impasse is shown, the proponent of waiver must demonstrate prejudice, something the Court doubts could ever be shown.

Much like *Johnson*, the Court has closed any loophole to successful assert

waiver of the appraisal clause. Better stated, an appraisal demand can never be waived.

E. WHAT'S LEFT?

After taking away strategies of limiting appraisal to merely the amount of loss with no considerations for causation and eliminating waiver to prevent appraisal, is there any way to upend an appraisal demand before it is ordered by a court? The answer is maybe.

The area that has unresolved by significant Court rulings and opinions is the area of competency and impartiality of the appraisers. Property insurance policies typically include a provision requiring that each party (insurer and insured) select an appraiser that is competent and impartial or disinterested. Just what this means is not entirely clear. Furthermore, just when a challenge to the competence and impartiality is proper is likewise unclear.

There are few cases on the issue of appraiser impartiality and none this author could locate in Texas dealing with appraiser competence. Certainly competence must be a consideration, otherwise the use of the term "competent" would be rendered meaningless, a result that the Courts reject. This reasoning would be equally applicable to the terms "disinterested" or "impartial".

The position of appraiser has been written about as far back as eighty years ago. *Pennsylvania Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm'n App. 1931, no writ). In *W. T. Waggoner*, the Court wrote:

> The policy by its terms required that the insured and insurer select competent and disinterested appraisers. They constitute a quasi court, and should be free from partiality and bias in favor of either party. Our Supreme Court, in the case of *Delaware Underwriters et al. v. Brock*, 109 Tex. 425, 211 S.W. 779, 780, speaking through Judge Greenwood, in passing upon the qualification of appraisers provided for under a similar policy, says:
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> " . . . The Alabama Supreme Court clearly gave the right construction to the appraisal clause in these

policies, when it said: "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." And, if this provision of the policy was not carried out in this spirit and for the purpose, neither party is precluded from going to the courts, notwithstanding the agreement to submit their differences to the board of appraisers.' *Hall Bros. v. Western Assurance Co*., 133 Ala. 639, 640, 32 So. 257, 258."

Id. at 594-595.

Translated, the appraisers and umpire are not either parties' expert and must act in a quasi judicial capacity. They are not beholden to either side. For example, drafting a party's expert as an appraiser would not satisfy the impartiality under *W.T Waggoner*.

A review of Texas cases on this subject turns up some cases, but actually only one actual published case. In *General Star Indemnity Co. v. Spring Creek Village Apts. Phase V, Inc*. and insurer challenged an appraisal that resulted in an award from the insured's appraiser and umpire. 152 S.W.3d 733, 734-737 (Tex. App. - Houston [14th Dist.] 2004, no writ). The insured in *General Star* agreed to pay its appraiser a 5% contingency of the gross settlement amount. *Id*. at 737.

The Houston Court of Appeals reversed the summary judgment granted to the insured on the binding nature of

appraisal. *Id*. at 337. Because the insured's appraiser had a financial/pecuniary interest in assessing the amount of loss, his impartiality could reasonably be questioned. *Id*.

In *Holt v. State Farm Lloyds*, the insured challenged the impartiality of State Farm's appraiser - Tim Marshall from Haag Engineering. 1999 WL 261923*1 (N.D. Tex 1999). It issue was whether Marshall who derived approximately one-quarter of his income from State Farm appraisal work was impartial. *Id* at *4. The federal court declined to grant summary judgment on the binding nature of appraisal finding a fact issue on Marshall's impartiality. *Id.*

Significantly, other courts have rejected impartiality challenges where the appraiser's employer rather than the appraiser individually was attached. *See Gardner v. State Farm Lloyds*, 76 S.W.3d 140 (Tex. App. – Houston [1st Dist.] 2002, no pet.). *See also Bunting v. State Farm Lloyds*, 2000 WL 191672 (N.D. Tex. 2000).

Impartiality remains an issue where the appraisal process may be challenged pre appraisal. Impartiality though is no easy roadblock to prevent appraisal. Generalities will not work.

The issue of competence has not been litigated with any reported decisions. Nevertheless, it would seem that an appraiser may well have to satisfy the Robinson criteria to make his findings valid. *See E.I. du Pont de Nemours v. Robinson*, 923 S.W.2d 549 (Tex. 1995). A competency argument would seem to be especially compelling when there are multiple causes for a loss such as a hurricane involving both wind and water perils. Given the substantial amount of losses due to multiple perils such as a hurricane, the competency of the appraiser cannot be considered insignificant.

The Texas Supreme Court's love affair with appraisal has left open the door

about the competency and impartiality if only for awhile.

F. SOME COMMENTARY

1. *Johnson*

First, it is ironic, but certainly laudable, that an insurer would be the party complaining about appraisals with the Texas Supreme Court at least implicitly contending that its decision was pro insured. Given the enormous resources of insurers, they are certainly in the best position to reap the benefits of *Johnson* and of course they now have. In theory, appraisal is now a prelitigation process without lawyers, judges, lawsuits, process, discovery, and juries. *Johnson*, 290 S.W.2d at 894. Insurers have access to numerous experts who they use over and over again and insurers are sophisticated in the appraisal process. The insured without representation is at an obvious disadvantage. The reasoning in *Johnson* would seem to bind the insured to damages and issues of causation as it relates to the loss, thereby permitting trial by appraisal.

Undoing the appraisal puts a tremendous burden on the unsophisticated insured who may become aware of the binding results of an appraisal too late. As State Farm stated – it forces the losing party to "unring the bell." Because appraisal will be viewed as presumptively a legitimate process, the Courts will be swayed to enforce the award no matter how the results are obtained or unjust – just like a binding mediated or arbitration agreement.

The *Johnson* decision is not pro-consumer. An insured will bear the costs of appraisals for its own appraiser and often likely one-half the cost of an umpire. It may require the insured to take on an additional burden of proving the appraisers exceeded their authority or that liability has been decided. This may require depositions, the hiring of other experts, and of course, attorney's fees. The Court has complicated

> a rather simple process which has been used properly if we are to conclude, as the court does, that the scarcity of cases means appraisal works. Appraisal after *Johnson* would seem to be acceptable for almost every property claim.

Much like health care liability cases which require the use of expert reports before the case may proceed and the multiplicity of appellate litigation about the sufficiency of these expert reports, the Supreme Court has created a whole new area of satellite litigation. The Court has greatly expanded mandamus litigation to intercede in the trial court process to address unnecessary discovery and proceedings, evaluate arbitration requests, examine the granting of new trials and avoidance of wasted judicial resources, etc. *See In Re Columbia Medical Center*, 290 S.W.3d 204, 215-216 (Tex. 2009) (O'Neill, J. dissenting). The *Johnson* opinion seems contrary to the Supreme Court's willingness to uncomplicate trials and keep litigation costs down. The standard to undo an appraisal is hardly simple or easy to satisfy. The Court did no one any favors with this decision.

An examination of existing case law at the time *Johnson* was decided calls into question the reasoning of *Johnson.* For example and not by way of limitation: appraisal may be invoked in the lawsuit itself. *Allstate,* 85 S.W.3d at 196; a request for appraisal must be made within a reasonable time. *American Fire Ins. Co. v. Stuart*, 38 S.W.395 (Tex. Civ. App. – 1996, no writ) (58 day delay); *Boston Ins. Co. v. Kirby*, 281 S.W. 275 (Tex. Civ. App. – Eastland 1926, no writ) (59 day delay); and a trial court may determine the timing of appraisal and abatement is not mandatory. *In re Terra Nova*, 992 S.W.2d 741, 742 (Tex. App. – Texarkana 1999, orig. proceeding) (also holding trial court has discretion to decide if appraisal is to take place at all when contractual and bad faith

claims are brought together). And prior to the Texas Supreme Court's decision in *Johnson*, but after *Wells*, it was settled law that the appraisal clause must be strictly construed. *Richardson v. Allstate Texas Lloyds*, 2007 WL 1990387 (Tex. App. – Dallas 2007, no pet); *Laird v. CMI Lloyds*, 261 S.W.3d 322, 326 (Tex. App. – Texarkana 2008, rev. dism'd w.o.j.); *Germania Farm Mut. Ins. Co. v. Williams*, 2002 WL 32341841 (Tex. App. – Eastland 2002, no pet); *General Star Indem. Co. v. Spring Creek Village Apartments Phase V, Inc.*, 152 S.W.3d 733 (Tex. App. – Houston [14th Dist.] 2004, no pet); and *Hartford Lloyds Ins. Co. v. Yarborough*, 2006 WL 1469705 (S.D. Tex. 2006).

The *Johnson* opinion noted at least three (3) cases that held causation cannot be determined by appraisers with Wells being the most frequently relied upon. *Wells* has been widely cited and applied with little or no confusion. 919 S.W.2d 679 (Tex. App. – Dallas 1996, writ denied). To recap, in *Wells*, the appraisers were called upon to determine the damages due to a foundation movement of a home. *Id.* at 682. The appraisers and umpire arrived at a figure of $22,875.94. *Id.* However, the insurer's appraiser and umpire determined that the damage related to the plumbing leak was zero. *Id.* The trial court granted summary judgment in favor of the insurer, denying the Plaintiffs' claim. *Id.* The Plaintiffs appealed and the Dallas Court of Appeals determined that appraisal was limited to determining the "amount of money involved in the controversy." *Id.* at 685. An appraisal is not to be used to determine liability, causation, or coverage. *Id.* at 683-684. *Wells* makes it clear that appraisal is improperly used and has no binding effect if causation, coverage, or liability is decided by the appraisers and/or umpire.

The Supreme Court, in contrast to *Wells*, cites *Lundstrom* for the proposition of

appraisers determining coverage. *Johnson*, 290 S.W.3d at 892. But in *Lundstrom*, the insureds did not participate in appraisal and USAA made its appraisal demand for the interior of the home caused by the initial wetting. *Lundstrom*, 192 S.W.3d at 82. The appraisal award was for $4226.19 which amounted to $1,666.19 after applying the deductible. *Id.* The insured cashed the appraisal award check. *Id.* Furthermore, USAA's appraisal demand was limited to the interior of the home from the initial wetting and *not* ongoing leaking or mold which had resulted which was a coverage issue and had been previously denied. *Id*. at 87. The scope of appraisal was specifically stated and not objected to. *Id.* USAA also noted in their appraisal demand that all that was at issue was property damage not "policy conditions or coverage." *Id.* The *Lundstrom* court found there were no coverage issues before the appraiser/umpire and there was no partition in the appraisal award according to causes. *Id*. at 89.

Instead of limiting its decision to the particular facts of the case or even ruling that appraisal could take place as to the roof without regard to cause, the Supreme Court in *Johnson* embarked on a lengthy discussion that the amount of damages necessarily includes causation, thereby broadly expanding the function of appraisal. But liability in an insurance claim necessarily includes coverage; if there is no coverage it is well settled law that no payment is due (absent some unique circumstances).

The Texas Supreme Court in *Johnson* apparently holds that it is proper for appraisers (umpires) to factor in cause in evaluating damage. This may be done implicitly by considering what is hail damage versus what is wear and tear. Thus, based on the reasoning of *Johnson*, the appraisers must necessarily decide what is

the amount of damage due to hail versus wear and tear. And according to this same reasoning, the amount determined in appraisal will be binding on both Johnson and State Farm. What then is left for trial?

Since State Farm is asserting coverage/causation precludes payment for anything more than the rigid line shingles as opposed to the entire Johnson roof, if there is an appraisal award for $10,000 as a result of the Johnson's appraiser and umpire agreeing, can State Farm litigate coverage or challenge the basis for the appraisal award, regardless of whether the award is silent on causation? Can State Farm unring the bell?

The Texas Supreme Court for whatever reason has taken a rather simple process and needlessly complicated it. Simply because the appraisal clause exists in an insurance policy does not mean that if it is not used then it makes its inclusion meaningless or that the appraisal clause in a property policy is a one size fits all method for determining damages.

Appraisal was not meant to be used in every first party property case. It was designed to be employed in circumstances such as grandmother's antique diamond ring being stolen, an event covered by the policy. There is *no controversy* as to what extent the ring is covered. Appraisal properly framed is that the insured says the ring is worth $5,000 while the insurer argues the value is $1,000. Appraisal would certainly be proper and an efficient means of resolving the issue of damages, the value of grandmother's stolen antique diamond ring.

In contrast though, where there are multiple causes of a loss, some covered and others not, an appraisal which includes appraisers (umpires) undertaking causation, implicitly or expressly, whether stated in the award or not, when evaluating the amount of loss confuses the parties, the court, what is to be tried, and the binding effect of the

award. Thus, the Supreme Court's discussion in *Johnson* is frankly not helpful and does not make appraisal attractive.

What the Texas Supreme Court in *Johnson* is apparently saying is that once a party requests appraisal, it must take place. Additionally, courts should not get involved with the propriety of appraisal before it takes place; rather, any problems with appraisal such as appraisers exceeding their authority, determining liability, etc. can and should be dealt with post appraisal. Determining damages necessarily includes causation. Given the rule that a court will indulge every reasonable presumption to sustain an appraisal award, the burden to undo it or have it set aside is on the party challenging the award. *Lundstrom*, 192 S.W.3d at 87. Obviously, if you are on the wrong end of appraisal, you have an uphill battle.

The Court, only in the last few sentences of its *Johnson* opinion, suggests that when appraisal may be too expensive or coverage so unlikely that in these circumstances appraisal might be avoided; preemptive action by the courts might then be proper. *Johnson*, 290 S.W.3d at 895. But what if an insured cannot afford to hire and pay an appraiser? Must he default in favor of the decision of the insurer's appraiser and the umpire? And if the appraisal involved a commercial building where multiple perils were involved, some covered and others not, must the insured or for that matter the insurer pay hundreds of thousands of dollars towards an appraisal that is rendered a nullity?

The language in the Supreme Court's opinion in *Johnson* that the amount of loss is always going to be an issue in a property case pre-suit and the Court's undoubted propensity for arbitration would seem to lead to the conclusion that the Court views appraisal as some sort of alternative dispute resolution like procedure which can lessen

or even avoid litigation between insurer and insured and appraisal must be working due to the "scarcity" of decisions on the subject. *See In Re Allstate*, 85 S.W.3d at 199 (Baker, J. dissenting). These perceptions are not only questionable, but seemingly counterproductive to both insureds and insurers. *Id.* It is also disadvantageous to insureds. *Id.* at 195 (noting the contentions of insureds that appraisal is costly and insureds are unlikely to challenge insurer's valuations). Given the Court's rationale and reasoning, we may have now arrived at trial by appraisal, or at the least trial to undo appraisal.

So, if the appraisal award in *Johnson* turns out to be $5,000, will State Farm be able to show that the award factored in covered and noncovered perils? Or now by definition, is the award which factors in causation, but does not mention cause, unchallengeable or a proper exercise of authority of appraisers and the umpire? And if the award is properly challenged and negated, is appraisal helpful at all? Agreeing on a number does not imply or concede liability or does it?

2. Universal Underwriters

The recent decision in *Universal Underwriters* is perhaps even more troubling. Because prejudice can never be shown according to the opinion, insurers will be free to invoke appraisal at any time for any reason including delay purposes.

Moreover, the "impasse" requirement invites all sorts of mischief. A simple denial of the claim by the insurer is not enough. Imagine an insurer using appraisal as a litigation tactic to flush out an insured's strategy or create economic disparity forcing an insured to pay for an appraisal. Insurers, more often than not, have more and larger financial resources than an insured. Requiring an insured to go through an appraisal which the insured later must challenge needlessly increases the

costs of a claim and takes up valuable court resources to undo the appraisal.

The Court simply overlooks that the insurance policies are drafted by insurers and these entities will do everything to preclude to waiver regardless of their conduct.

Appraisal is not an inexpensive and efficient means to resolve a dispute when the insurer denied all liability in the first place or has made their final offer. Requirements of impasse and prejudice are ever more disconcerting when appraisers may be able to determine causation, coverage, and/or liability.

It is the little guys who will suffer the most from *Universal Underwriters*.

H. CONCLUSION

Appraisal is intended to be an efficient and inexpensive method to determine damages. But when issues of causation, including concurrent causation, and coverage, are at issue, the efficiency, expense, and usefulness of appraisal must be called into question. Nevertheless, the Texas Supreme Court in *Johnson* has clearly indicated appraisal should take place without court intervention and let the results be sorted out later. Given the presumption in favor of the results of appraisal, it causes the "loser" of appraisal to have to undo the results. With the Texas Supreme Court's holding, we have arrived at trial by appraisal. It goes with the old saying "shoot first and ask questions later."

And if you thought waiver might work, you are out of luck. Since you can never satisfy the prejudice standard, whether an "impasse" has occurred seems immaterial.