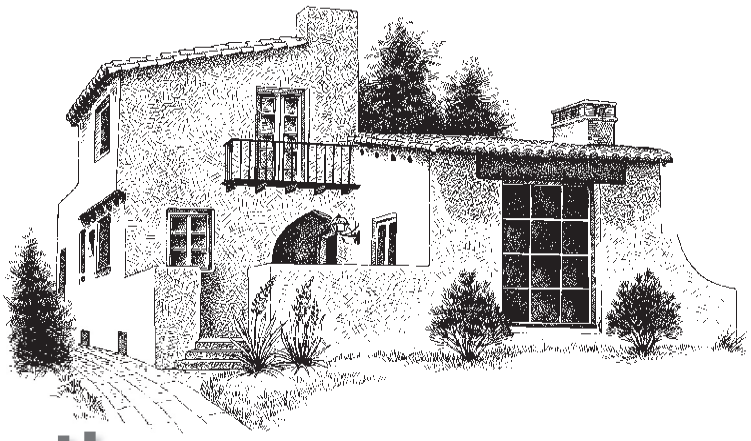
AN OUTLINE OF ITS EFFECT ON THE CLAIM PROCESS



The Appraisal Provision in the Texas Homeowner's Insurance Policy

By Charles Levy*

I. Introduction

The various Texas Homeowner's Insurance Policy forms set forth a provision in the "General Conditions" section of the policy that provides the terms and conditions under which an insured and insurer must submit pending claims to an "appraisal" process. The effect of this appraisal process can be significant, particularly with regard to the amount of loss at issue. Thus, it is incumbent upon attorneys involved with homeowner's insurance claims to have a working knowledge of the appraisal provision. This article attempts, in outline form, to provide a somewhat comprehensive summary of issues pertaining to the appraisal provision found in the Texas Homeowner's Insurance Policy forms.

II. Overview

A. The Appraisal Provision

The Texas Homeowner's Insurance Policy, a standard form policy promulgated by the Texas Department of Insurance, contains an appraisal clause. Under this clause, either party may invoke an appraisal if the party disagrees with the value of a claim or claims. Each party hires its own appraiser, and if the two appraisers cannot agree on the value, they select an umpire. If the appraisers cannot agree on an umpire, a district judge can be petitioned to appoint the umpire. A decision signed by any two of the three becomes binding as to the value of the claim.[1]

B. Appraisal Provision Example[2]

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 you or we request that they do so, the appraisers will also set:

- The full replacement cost of the dwelling.
- The full replacement cost of any other building upon which loss is claimed.
- The full cost of repair or replacement of loss to such building, without deduction for depreciation.

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 the 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.

C. Case Law and the Policy Language

Texas case law exists that has interpreted and applied the language found in the appraisal provision of the Texas Homeowner's Insurance Policy.[3]

D. Abatement of Suit Pending Appraisal

1. An insurer (and an insured, if appraisal is requested) is entitled to have the appraisal procedure followed and suit on the insurance policy abated until the completion of the appraisal procedure.[4]
2. Where an insurance policy mandates appraisal to resolve the parties' dispute regarding the value of a loss, and where the appraisal provision has not been waived, a trial court abuses its discretion and misapplies the law by refusing to enforce the appraisal provision.[5]
3. Abatement is appropriate based upon the "no suit or action" clause found in most insurance policies. Such a provision typically provides that "no suit or action can be brought unless the policy provisions have been complied with."[6]
4. However, regarding abatement, failure of a trial court to grant a motion to abate is not subject to mandamus.[7] Thus, a trial court will not abuse its discretion by denying a request for abatement.[8]

E. Waiver of the Appraisal Requirement

In *Int'l Serv. Ins. Co. v. Brodie*, the trier of fact found that the appraisal was not requested within a reasonable time.[9] The insured alleged that by virtue of the delay the insurer had waived the requirement for appraisal (the appraisal was requested 72 days after the insurance adjuster viewed the premises and the parties disagreed as to the loss). The court held that the appraisal provision was "inserted wholly for the protection of the insurer," but that the insurer "will not be permitted to use this clause oppressively, or in bad faith," and that the insurer "must proceed promptly to take the necessary steps to have the amount of the loss adjusted as provided in the policy…."[10]

F. Timeliness of Request for Appraisal

In the absence of a deadline for demanding appraisal under the policy's appraisal provision, an insurer will not waive its request for an appraisal by failing to assert it within some contractually specified time period.[11]

III. Enforceability of an Appraisal Decision

A. An appraisal decision made pursuant to the provisions of an insurance contract is binding and enforceable.[12]

B. Every reasonable presumption will be indulged to sustain an appraisal decision.[13]

IV. Estoppel Effect of an Appraisal Award

A. The effect of an appraisal award is to estop a party, i.e., the non-requesting party, from contesting the issue of damages in a suit on the insurance contract, leaving only the question of liability for the court.[14]

B. As with other affirmative defenses, the party seeking to estop the other party from contesting the issue of damages must raise the issue of estoppel.[15]

V. Limitation of an Appraisal to a Determination of the Amount of Loss

A. Appraisers may only determine the amount of loss and may not assess causation, coverage, or liability for the damage.[16]

B. The appraisal section of the policy does not authorize and empower the appraisers to determine what caused or did not cause the loss claimed.[17]

VI. Setting Aside an Appraisal Decision

A. An appraisal award may be set aside in three instances:

1. when it was made without authority;
2. when it was the result of fraud, accident, or mistake; or,
3. when it was not made in substantial compliance with the terms of the contract.[18]

B. "Unfairness" of the *result* is not an independent ground for disregarding an appraisal award.[19]

C. A party challenging the appraisal process or appraisal award should allege in their pleadings that the appraisal award should be set aside, and should specify the basis for setting aside the award.[20]

VII. Lack of Authority of an Appraiser

A. An appraisal must be conducted by the persons authorized to make such appraisal award in manner that complies with the appraisal provision of the insurance policy.

B. Substitutions made by the appraisal companies, not the parties, particularly if no objection is made by a party at the time of such substitution, will likely give rise to an argument that the substitute appraiser had implied or apparent authority to act of behalf of a party.[21]

C. An umpire does not exceed the authority conferred upon him when, in the exercise of his own judgment and as the result of his own investigation, he determines the cost values of the disputed items, independent of either the joint or individual findings of the appraisers.[22]

D. An appraiser's acts in excess of the authority conferred upon him by the appraisal agreement are not binding on the parties.[23]

VIII. Fraud, Accident or Mistake

A. Fraud

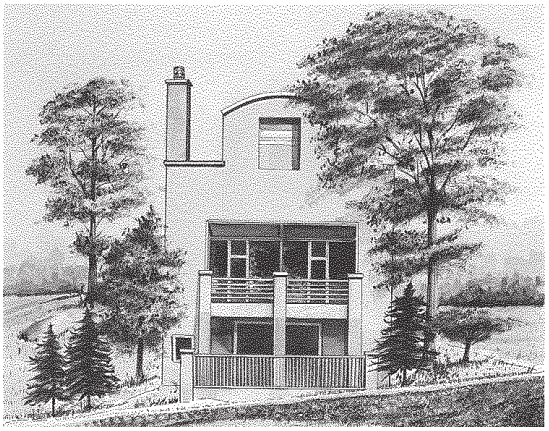
Examples of fraud would include: the appraiser intentionally prevents a claimant from receiving like kind and quality replacement; the appraiser fails to use available price and quality information; the appraiser intentionally excludes items from the appraisal process; and the appraiser bases his calculations on fraudulent bids from unqualified contractors.[24]

B. Accident or Mistake

1. One court has defined "mistake" as "a situation where the appraisers and umpire were laboring under a mistake of fact by which their appraisal award was made to operate in a way they did not intend, such that the award does not speak the intention of the appraisers and umpire, or where the error resulting in the award is so great as to be indicative of gross partiality,

undue influence, or corruption."[25]

2. A mistake is more than a clerical error. A clerical error that does not affect the intention of the appraisers cannot support a finding of mistake.[26] Further, the court will not substitute its own award for that of the appraisers unless the mistake is one by which the award fails to operate in a way the appraisers intended.[27]



An appraisal must be made by an unbiased, impartial appraiser.

IX. Lack of Contractual Compliance: Bias or Impartiality of Appraiser[28]

1. An appraisal must be made by an unbiased, impartial appraiser.
   a) An appraiser with a financial interest in the outcome of the appraisal is not impartial.[29] However, this may only raise a fact issue regarding impartiality.[30]
   b) Most courts hold that an appraiser is "independent" unless he has a direct, pecuniary interest in the outcome of the appraisal.[31] One authority has explained that a disinterested or independent appraiser is one "not only without pecuniary interest, but impartial, fair, open-minded, and without partisanship, prejudice, or bias."[32]
2. "[A] finding of disparity, even gross disparity, between an appraisal award and the cost of repair, cannot support a finding of bias or partiality without additional evidence."[33]
3. The showing of a pre-existing relationship, without more, does not support a finding of lack of independence.[34]
   a) Evidence of the following may demonstrate a lack of independence: the exercise of influence or control over the appraiser; the appraiser's past employment by a party; a financial interest in the claims; instructions regarding how costs should be determined, i.e., from figures supplied by a party, not from figures determined by the appraiser; and a lack of exercise of independent judgment in the appraisal process.[35]
   b) Generally, evidence that demonstrates something other than an arm's-length business relationship may demonstrate a lack of independence[36]
4. Only one Texas decision discussing a need to demonstrate prejudice arising from the lack of impartiality was found. In *Gen. Star Ind. Co. v. Spring Creek Vill. Apartments*, the court indicated that the disparity between two appraisals (and reliance thereupon by the umpire) was sufficient to show that General Star was prejudiced if the appraiser lacked impartiality, without *per se* holding that prejudice was required.[37]

X. Timely Objection to an Appraisal

A. When a party has knowledge of a disqualifying relationship and has an opportunity to object to the appraiser, he waives the objection and may not be heard to complain after the award is made.[38]

B. Failing to oppose an appraiser until after determination of the appraisal raises the issue of waiver.[39]

C. Caution: To avoid the issue of waiver of objection to the appraisal process or the award in the appraisal process, once appraisal is requested by a party, the non-requesting party should carefully review the appraisal provision to ascertain if appraisal has been properly requested. Thereafter, such party should carefully monitor the appraisal process to ensure that the process proceeds in accordance with the appraisal provision. All known objections should be made as soon as such objections reasonably appear to exist.

XI. Other Issues

A. Payment of Appraiser

If the appraisal provision so provides, each party must pay its own appraiser and bear the other expenses of the appraisal and an umpire equally.[40]

B. Itemization of Appraisal Award

If the appraisal provision so provides, then the umpire's decision must be sufficiently itemized to be in compliance with the provision.[41]

C. Effect of an Appraisal for an Amount Greater Than the Amount Paid by the Insurer

Several Texas cases have failed to find a breach of contract by the insurer even if an appraisal award is different from the amount initially offered or paid by the insurance company. The courts have found no breach where the insurance policy specified that an appraisal process was the remedy for any disagreement regarding the amount of loss, that the decision reached by the umpire would "set the amount of loss," that "such an award [would] be binding" participation by the insurer and claimant in the appraisal process, and where the insurance company timely tendered the amount awarded by the umpire.[42]

D. Non-Waiver of Terms or Conditions of Policy

In *Savan Corp. v. Interstate Fire & Cas. Co.*,[43] the court held that the insurer could assert the affirmative defense that Savan failed to mitigate

damages, despite the existence of an appraisal award, as Interstate had advised the insured in writing that the appraisers decision would not alter the terms of the policy." Thus, in the letter agreeing to appraisal, Interstate explicitly did not waive the insured's duties in the event of loss or damage.

E. Extracontractual Claims

Claims for breach of the duty of good faith and fair dealing, including statutorily based extracontractual claims, are outside of the bounds of the appraisal decision.[44] Thus, damages resulting from such a breach are not limited to the amount of the appraisal decision.[45]

XII. Conclusion

This outline illustrates how important it can be for a consumer and their attorney to monitor and participate in the appraisal process when making a claim under a homeowner's insurance policy. Consumers have been provided with the ability to protect their rights, but these rights become meaningless unless they are asserted in an appropriate and timely manner. When it comes to the appraisal provisions of a homeowner's insurance policy, knowledge truly is power.

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1. *See*, *e.g.*, Allison v. Fire Ins. Exch., 98 S.W.3d 227, 253 (Tex. App.—Austin 2002, *pet. granted, judgm't vacated w.r.m.*).

2. This provision was taken from the Standard Texas Homeowner's Policy, Form-B, previously offered for sale in Texas. Currently, the language in such form provides: **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 loss. If the appraisers submit a written report of an agreement to us, the amount agreed upon shall be the amount of 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.

3. *See*, *e.g.*, Breshears v. State Farm Lloyds, 155 S.W. 3d 340 (Tex. App.—Corpus Christi 2004, *pet. denied*). In Breshears, as referenced by the Court at the outset, the insurance contract contained this appraisal provision:

> 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.... The two appraisers will then choose an umpire.... 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 the loss. Such award shall be binding on you and us.

Id. at 342.

4. *See* Vanguard Underwriters Ins. Co. v. Smith, 999 S.W.2d 448, 451 (Tex. App.—Amarillo 1999, *orig. proceeding*).

5. *See In re* Allstate County Mut. Ins. Co., 85 S.W.3d 193, 195-96 (Tex. 2002, *orig. proceeding*) (holding that the trial court abused its discretion by construing appraisal provision as arbitration agreement and refusing to enforce it), and *Vanguard Underwriters*, 999 S.W.2d at 451 (granting a conditional writ of mandamus with instructions to only issue the writ if the trial court failed to compel the appraisal and abate the underlying suit).

6. *See*, *e.g.*, *Vanguard Underwriters*, 999 S.W.2d at 450.

7. *In re* Allstate, 85 S.W.3d at 196 (Tex. 2002).

8. *See Id.*

9. 337 S.W.2d 414, 416 (Tex. Civ. App.—Fort Worth 1960, *writ ref'd n.r.e.*).

10. *Id.*, at 417 (citations omitted). *But see* In re Clarendon Ins. Co., No. 2-04-305-CV, 2004 Tex. App. LEXIS 11537 (Tex. App.—Fort Worth, Dec. 23, 2004, *orig. proceeding*) (post-suit request for appraisal by insurer upheld).

11. In *In re Clarendon*, Clarendon's payment of the claimant's invoices for four months did not constitute a waiver of the appraisal provision, as Clarendon intended to examine the repairs performed by the insured and match the repairs to the invoices submitted, as it was entitled to under the policy provision requiring the insured to permit Clarendon access to the damaged property. An appraisal became necessary only when the insured refused Clarendon access to the damaged property. *Id.*, at *8. In this case, according to the court, the record did not support the claimant's contention that Clarendon waived the appraisal provision. According to the court, "where an insurance contract like the one here mandates appraisal to resolve the parties' dispute regarding the value of a loss and where the appraisal provision has not been waived, a trial court abuses its discretion and misapplies the law by refusing to enforce the appraisal provision." *Id.* at *8-9. Importantly, it does not appear that Clarendon committed a breach of contract before the request for appraisal, despite the claimant's contention that it did so by failing to remit timely payments. Arguably, an insurer's denial of the claim before requesting an appraisal waives the requirement that the claim be submitted to an appraisal. *See*, *e.g.*, Sanders v. Aetna Life Ins. Co., 205 S.W.2d 43, 44-45 (Tex. 1947) (discussing this principle in the context of notices and proofs of loss). Note, however, that no Texas case directly on point could be found on this issue.

12. Wells v. Am. States Preferred Ins. Co., 919 S.W.2d 679, 683 (Tex. App.—Dallas 1996, *writ denied*) (citations omitted).

13. Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist., 877 S.W.2d 872, 875 (Tex. App.— San Antonio 1994, *no writ*).

14. Hennessey v. Vanguard Ins. Co., 895 S.W.2d 794, 797-98 (Tex. App.—Amarillo 1995, *writ denied*). Further, in *Scottish Union & Nat'l Ins. Co. v. Clancy*, 8 S.W. 630, 631 (Tex. 1888), the Texas Supreme Court concluded that, while arbitration determines the rights and liabilities of the parties, appraisal merely "binds the parties to have the extent or amount of the loss determined in a particular way." Texas courts have continued to recognize this distinction, as has the United States Court of Appeals for the Fifth Circuit. *See, e.g.*, Standard Fire Ins. Co. v. Fraiman, 514 S.W.2d 343, 344 (Tex. Civ. App.—Houston [14th Dist.] 1974, *no writ*); Hartford Lloyd's Ins. Co. v. Teachworth, 898 F.2d 1058, 1061-62 (5th Cir. 1990). Texas courts have continued to enforce appraisal clauses since the 1888 *Scottish Union* decision. *See*, *e.g.*, Glens Falls Ins. Co. v. Peters, 386 S.W.2d 529, 532 (Tex. 1965), and *Vanguard Underwriters,* 999 S.W.2d at 451.

15. *Allison*, 98 S.W.3d at 253; *see also* Tex. R. Civ. P. 94.

16. *See Wells,* 919 S.W.2d at 684; *see also* Holt v. State Farm Lloyds, CA 3:98-CV-1076-R, 1999 U.S. Dist. LEXIS 6257, at *7 (N.D. Tex. Apr. 21, 1999).

17. *Wells*, 919 S.W.2d at 684. In *Wells* the Court held,

> [W]e must conclude that the appraisal clause at issue pertains to a dispute over the amount of money involved in the controversy. Indeed, we read the phrases "actual cash value," "amount of loss," and "cost of repair or replacement" as triggering the demand for appraisal. It cannot be doubted that these are "dollar" controversies. Thus, nowhere do we read a "causation dispute" or a "liability dispute" as the means or manner by which the demand for appraisal can be made operative…. We conclude that the authority of the appraisal panel in the present case was limited to determining only the amount of loss. Therefore, we 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 Wellses' property. It follows, and we so hold, that the appraisal section of the Texas Homeowner's Policy quoted above establishes an appraisal procedure to determine the dollar amount of the insured's loss only, and that it does not authorize or empower the appraisal panel created thereunder to determine what caused or did not cause that loss. Indeed, we hold that, absent an agreement to the contrary, questions of what caused or did not cause the loss are questions to be decided by the court. Moreover, we hold that participation by the insured in the appraisal process does not constitute agreement by the insured to authorize and empower the appraisal panel to determine questions of what caused or did not cause the loss.

Id. at 685.

18. *Wells*, 919 S.W.2d at 683; *Providence Lloyds*, 877 S.W.2d at 875-76.

19. *Hennessey*, 895 S.W.2d, at 798.

20. *See*, *e.g.*, Franco v. Slavonic Mut. Fire Ins. Ass'n, 154 S.W.3d 777, 785-86 (Tex. App.—Houston [14th Dist.] 2004, *no pet.*).

21. Bunting v. State Farm Lloyds, No. 3-98-CV-2490-BD, 2000 U.S. Dist. LEXIS 1674, at *11 (N.D. Tex. Feb. 14, 2000); *see also* Toonen v. United Servs. Auto. Ass'n, 935 S.W.2d 937, 941 (Tex. App.—San Antonio 1996, *no writ*).

22. *Providence Lloyds*, 877 S.W.2d at 877.

23. Fisch v. Transcontinental Ins. Co., 356 S.W.2d 186, 190 (Tex. Civ. App.—Houston 1962, *writ ref'd n.r.e.*).

24. *See*, *e.g.*, *Allison*, 98 S.W.3d at 253.

25. Barnes v. W. Alliance Ins. Co., 844 S.W.2d 264, 268 (Tex. App.—Fort Worth 1992, *writ dism'd by agr.*) (quoting district court's Jury Instruction No. 14-C).

26. *See Providence Lloyds,* 877 S.W.2d at 878 n.6 (column labeled "court award" instead of "agreed award" did not constitute a mistake).

27. Gulf Ins. Co. of Dallas v. Pappas, 73 S.W.2d 145, 146 (Tex. Civ. App.—San Antonio 1934, *writ ref'd*).

28. The appraisal provisions found in the (standard) homeowner's policy provide for a competent, independent appraiser, or competent, disinterested appraiser. This is wholly consistent with the discussion found in the cases set forth in this article, which, to the extent competence or independence of the appraiser is in issue in such cases, set forth policy language providing for a competent, independent (or disinterested) appraiser.

29. *See* Delaware Underwriters v. Brock, 211 S.W. 779, 780-81 (Tex. 1919) (citation omitted).

30. *See*, *e.g.*, Gen. Star Ind. Co. v. Spring Creek Vill. Apartments Phase V, Inc., 152 S.W.3d 733, 737 (Tex. App.—Houston [14th Dist.] 2004, *no pet.*).

31. *See*, *e.g.*, *Bunting*, 2000 U.S. Dist. LEXIS 1674, at *10. *But see Holt*, 1999 U.S. Dist. LEXIS 6257, at *13 (summary judgment not proper where evidence showed that appraiser derived more than one-quarter of his income from work done for insurance company).

32. 14 George J. Couch, et al, Couch on Insurance § 50:137 (2d rev. ed. 1982).

33. *Hennessey,* 895 S.W.2d at 799.

34. Gardner v. State Farm Lloyds, 76 S.W.3d 140, 143 (Tex. App.—Houston [1st Dist.] 2002, *no pet.*). "Mere fact that one appointed by the insurer as an appraiser . . . has acted in a similar capacity on other occasions for the insurer,... does not, as a matter of law, disqualify such appraiser or warrant the setting aside of the award.... the prior service of an appraiser for the party appointing him is a circumstance to be taken into consideration, together with the other surrounding circumstances, in determining whether an appraiser is sufficiently disinterested and impartial to qualify as a competent appraiser." *Couch on Insurance*, at § 50:140.

35. *See Allison*, 98 S.W.3d at 256-57.

36. *See*, *e.g.*, Mays v. Foremost Ins. Co., 627 S.W.2d 230, 234 (Tex. App.—San Antonio 1981, *no writ*), wherein the court discusses the quantum of evidence necessary to defeat summary judgment based on the preclusive effect of an appraisal award. In *Mays*, the insurer and its selected appraiser maintained a continuing business relationship, the insurer directed its appraiser to object to a former umpire upon which the appraisers had previously agreed, and the insurer acted in concert with the new umpire in determining the award. Based on that evidence, there were genuine issues of material fact about whether the appraisal procedure was complied with fully, fairly, and without undue influence by the insurer.

37. *Gen. Star*, 152 S.W.3d at 738.

38. Johnson v. Korn, 117 S.W.2d 514, 521 (Tex. Civ. App.—El Paso 1938, *writ ref'd*).

39. *Allison*, 98 S.W.3d at 253.

40. *See*, *e.g.*, *Allison,* 98 S.W.3d at 255.

41. *See*, *e.g.*, *Breshears,* 155 S.W.3d at 342.

42. *See*, *e.g.*, Brownlow v. United Servs. Auto. Ass'n, No. 13-03-758-CV, 2005 Tex. App. LEXIS 1987 (Tex. App.—Corpus Christi, Mar. 17, 2005, *pet. denied*) (holding that State Farm provided evidence establishing that it participated in the appraisal process and fully paid the amount set by the appraisers and umpire; thus, there was no indication in the policy that a payment made prior to appraisal that differs from the appraisal award amounts to a breach of contract); *Toonen*, 935 S.W.2d at 940 (holding that insurer was entitled to summary judgment on breach-of-contract claim because it had tendered appraisal award to claimant pursuant to contract); and *Providence Lloyds,* 877 S.W.2d at 879 (holding that appraisal award made pursuant to the insurance contract was binding and that appellee take nothing on its breach-of-contract claim).

43. CA 3:97-CV-3204-R, 1998 U.S. Dist. LEXIS 18585, (N.D. Tex. Nov. 18, 1998).

44. *Allison*, 98 S.W.3d at 256. *See also* In re Terra Nova Ins. Co., 992 S.W.2d 741 (Tex. App.—Texarkana 1999, *no pet.*) (appraisal not applicable to extra-contractual claims).

45. *Allison*, 98 S.W.3d at 256. *Cf. In re Allstate*, 85 S.W.3d 193 (wherein the court based its holding that the provision for appraisal was not an agreement to arbitrate on contract principles only and did not address the non-contractual claims).