Implications Posed by Insurance Appraisals

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Introduction

The appraisal process written under a typical property damage policy is a tool used to define the measure of coverage owed by a carrier. While intended to resolve disputes between a carrier and its policy holder, the potentially dispositive nature of this process may expose an insurer to claims of bad faith. On the other hand, the appraisal process may insulate an insurance carrier from bad faith given evidence of a bona fide dispute over the value of a claim. Either way, the appraisal process should be carefully considered as a form of alternative dispute resolution.

The Binding Nature of an Appraisal

Appraisal provisions within insurance policies "provide that when there is a dispute as to the amount of first-party benefits owed to an insured, either party may demand that the parties appoint an appraiser to determine the amount of an insured's loss."[1] The primary function of the appraisal process is to resolve disputes between insurers and insureds without the expense of litigation.[2] These disputes often concern the cause of an insured's loss. For example, an insured may file a claim for hail damage to roof and siding. After adjusting the claim, the carrier may contend that only the roof was damaged.

The Insurance Services Office's model appraisal provision provides that the insurer or insured may:

> demand an appraisal of the loss … . [E]ach party will choose a competent and impartial appraiser … . The two appraisers will choose an umpire. If they cannot agree upon an umpire…, [the insurer or insured] may request that the choice be made by a judge … . If the appraisers submit a written report of an agreement …, the amount agreed upon will be the amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will set the amount of loss.[3]

There are two approaches to the appraisal process. Either the process values the covered losses or the insured's claim is appraised with the carrier reserving on the issue of coverage. The implication of an insurer reserving on coverage should be carefully considered.

At least one Colorado State District Court has held that an appraiser's assessment "necessarily includes a determination of the cause of loss as well as the cost to repair the

[1] A.D. Windt, Insurance Claims and Disputes § 9:33, at 248.
[2] *Id.*
[3] Insurance Services Office Form HO 00 03 05 01, p. 15 (2000).

damages."[4] This opinion suggests that a carrier cannot reserve on coverage during the appraisal process. Consequently, attempts to adjust a claim based on coverage following an appraisal award might be considered unreasonable.

The appraisal may also be considered a legally binding process tantamount to arbitration. The Florida Court of Appeals considered whether an appraisal award had been "adjudicated adversely to the insurer" for purposes of satisfying a plaintiff's burden under Florida's statutory bad faith law.[5] Under Florida law, an insured must prevail on an underlying action for policy benefits in order to assert a statutory bad faith claim. The Florida Court of Appeals assessed an appraisal provision similar to the model ISO and held that, "[w]e see no meaningful distinction between an arbitration award and the appraisal award" for purposes of bringing a statutory bad faith claim.[6] Other states have also rendered decisions likening appraisals to arbitrations.[7]

Colorado courts have not addressed whether an appraisal provision constitutes an agreement to arbitrate. Under Colorado's Uniform Arbitration Act, the trial court decides whether parties have agreed to arbitrate.[8] If Colorado courts consider appraisal decisions the equivalent of an arbitration award, it would be binding on the insurer under most circumstances.[9] "The merits of an arbitrator's award are not subject to review by the courts," as the arbiter's determinations of law and fact are final.[10] If equivalent to binding arbitration, the carrier's objection to the appraisal award would conflict with a judicially enforceable mandate and therefore be considered unreasonable.

Reserving as Insulation from Bad Faith Claims

While reserving on coverage may pose risks to a carrier, it may to insulate the insurer from liability as well. In *Gold v. State Farm Fire & Cas. Co.*, 2013 WL 1910515 (D. Colo., May 8, 2013), the trial court held that differences between an insured's and insurer's loss valuations under the appraisal process evidenced a genuine good faith dispute as to value that did not support a claim of unreasonable delay.[11] Similarly, Colorado precedent also indicates an

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[4] *Ikeako v. Fire Ins. Exchange d/b/a Farmers*, 12CV2127 (Colo. State Dist. Ct., April 19, 2013) (citing *Cigna Ins. Co. v. Didimoi Prop. Holdings, N.V.*, 110 F. Supp.2d 259, 264 (D. Del. 2000)).
[5] *Trafalgar at Greenacres, Ltd v. Zurick American Ins. Co.*, 100 So.3d 1155 (2012).
[6] *Id.* at 1157.
[7] *See Wailua Associates v. Aetna Cas. Sur. Co.*, 27 F.Supp.2d 1211 (D. Hawai'i 1998) (applying Hawai'i law in diversity jurisdiction and indicating that an appraisal may be confirmed in the same manner as an arbitration and that, upon confirmation, an appraisal becomes a final judgment that may preclude relitigation through the doctrines of claim and issue preclusion); *and Emmons v. Lake State Ins. Co.*, 484 N.W.2d 712 (Mich. App. 1992) (stating that the appraisal process to settle a homeowner's insurance claim is a common law arbitration agreement).
[8] C.R.S. § 13-22-206(2).
[9] *See* C.R.S. § 13-22-222 (allowing a party in receipt of an arbitration award to seek confirmation of such award from a court); *and* C.R.S. § 13-22-223 (limiting grounds for vacating an arbitration award to a narrow set of circumstances such as fraud and procedural defect).
[10] *Foust v. Aetna Cas. & Ins. Co.*, 786 P.2d 450, 451 (Colo.App.1989).
[11] *Gold*, 2013 WL at *6.

appraisal that differs from the loss valuations of an insured protect the insurer against later bad faith claims because it shows a bona fide valuation dispute.[12]

Conclusion

While it is not entirely clear how the appraisal process will evolve under Colorado law, this form of dispute resolution should be carefully considered in the adjustment of a claim. An insurer seeking to reserve on coverage should understand the potential implication of the appraisal being considered final. At the same time, the appraisal may provide the carrier exculpatory evidence of a genuine dispute to defeat claims of bad faith. Either way, the appraisal process should be carefully considered when used as a form of alternative dispute resolution.

[12] *See Vaccaro v. Am. Family Ins. Group*, 275 P.3d 750, 759 (Colo. App. 2010) (holding that "it is reasonable for an insurer to challenge claims that are fairly debatable").