First-Party Insurance Disputes, Alternative Dispute Resolution Mechanism and Issues with Umpires and Appraisers

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IMPARTIALITY IN THE APPRAISAL PROCESS

I. OVERVIEW OF APPRAISAL

Appraisal under a first-party property insurance policy is meant to be an efficient and cost-effective manner in which to resolve disagreements over the amount of a loss. Appraisal provisions are almost uniformly included in property insurance policy forms. A bona fide disagreement over the amount of the loss is required in order for one of the parties to the policy to demand appraisal. Once invoked by one of the parties, appraisal is mandatory in most jurisdictions. Although the language can vary, the typical appraisal clause reads as follows:

> Appraisal
>
> If we and you disagree on the value of the property or the amount of the "loss," either may make written demand for an appraisal of the "loss." In this event, each party will select a competent and impartial appraiser. You and we must notify the other of the appraiser selected within twenty days of the written demand for appraisal. The two appraisers will select an umpire. If the appraisers do not agree on the selection of an umpire within 15 days, they must request selection of an umpire by a judge of a court having jurisdiction. The appraisers will state separately the value of the property and the amount of the "loss." If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be the appraised value of the property or amount of "loss." If you make a written demand for an appraisal of the "loss," each party will:
>
> a. Pay its chosen appraiser; and
> b. Bear the other expenses of the appraisal and umpire equally.

The appraisal process is extrajudicial, so it avoids the procedural nuances associated with most lawsuits.

Appraisal should not be confused with arbitration. Arbitration can encompass an entire controversy between parties. Appraisal is more narrow in scope; it does not resolve issues of coverage or other policy interpretation. Instead, appraisal is limited to determining the amount of the loss sustained, although some states permit the appraisers to determine causation. Appraisal also is much less formal. Indeed, there are no rules about how appraisal is conducted except for what is contained within the policy's appraisal provision itself.

Once appraisal is invoked, each of the parties much appoint an appraiser. The credentials for the appraisers are set forth in the policy's appraisal provision. Most policies restrict the qualification to a "competent and impartial appraiser." Other policies require each party to appoint a "competent and disinterested" or "competent and independent" appraiser.

II. APPRAISER QUALIFICATIONS

A. Competent Appraisers

The appraiser first must be competent. Competent is defined as "having suitable or sufficient skill, knowledge, experience, etc., for some purpose; properly qualified." www.dictionary.com. Merriam-Webster defines competent as "having requisite or adequate ability or qualities." www.merriam-webster.com. It is common that the parties will designate appraisers who are industry experts in the particular area of a dispute, such as a forensic accountant for a disagreement over the amount of a business interruption loss. A forensic accountant may not, however, be a competent appraiser for a dispute over the cost to repair building damages.

B. Disinterested or Impartial Appraisers

The policy also requires that each appraiser be "disinterested" or "impartial." Courts across the country continue to develop the law regarding what it means to be a "disinterested" or "impartial" appraiser in the context of appraisal under an insurance policy. But, in reality and practice, is there an actual distinction between the terms "disinterested" and "impartial?" Black's Law Dictionary defines "disinterested" as "'[f]ree from bias, prejudice, or partiality . . . not having a pecuniary interest in the matter at hand." Black's Law Dictionary (11th ed. 2019). "Impartial" is defined as "not favoring one side more than another; unbiased and disinterested; unswayed by personal interest." Based on the dictionary definitions of these terms, there does not seem to be much difference between a "disinterested" and "impartial" appraiser. Nevertheless, the answer will ultimately depend on the jurisdiction in which your case is pending.

1. Disinterested

Florida courts, in particular, have attempted to define "disinterested" in the context of the insurance appraisal process. Recently, Florida's Third District Court of Appeal, in ***State Farm Fla. Ins. Co. v. Sanders***, No. 3D19-927, 2020 Fla. App. LEXIS 5033, 45 Fla. L. Weekly 870 (Fla. 3d DCA 2020), denied State Farm Florida Insurance Company's request for a writ of certiorari to quash a Miami-Dade Circuit Court order that permitted homeowners Charles and Diana Sanders to appoint their public adjuster as their "disinterested" appraiser. The Sanders filed suit against State Farm alleging breach of contract for failure to pay their Hurricane Irma property damage claim. In response to the complaint, State Farm filed a motion to invoke appraisal under the insurance policy's appraisal provision, claiming that there was a pre-suit dispute regarding the Sanders' designated appraiser. The appraisal provision in the State Farm policy stated that, "Each party will select a qualified, disinterested appraiser . . . ." The parties entered into an agreed order granting the motion to invoke appraisal, which named State Farm's appraiser and required the Sanders to designate their "qualified, disinterested appraiser." The Sanders

chose their public adjuster, with whom they had entered into a contract that assigned 10% of the insurance proceeds recovered, to serve as their appraiser. State Farm moved to stay the appraisal because the Sanders' public adjuster did not qualify as a disinterested appraiser. The Sanders filed a motion to lift the stay and compel compliance with the order of appraisal, which the trial court granted.

In its original July 24, 2019 order, Florida's Third District Court of Appeal granted State Farm's petition for writ of certiorari to quash the trial court's order compelling appraisal and allowing the Sanders' public adjuster to act as their "disinterested" appraiser, holding that a public adjuster who is in a contractual agent-principal relationship with the insureds cannot be "disinterested" as a matter of law. ***State Farm Fla. Ins. Co. v. Sanders***, No. 3D19-927, 2019 Fla. App. LEXIS 11655, at *10-11 (Fla. 3d DCA July 24, 2019). In reaching its original decision, the court relied on the definition of "disinterested" adopted by the Fifth District Court of Appeal in ***Florida Insurance Guaranty Ass'n v. Branco***, 148 So. 3d 488, 490 (Fla. 5th DCA 2014) – "'[d]isinterested' is defined as '[f]ree from bias, prejudice, or partiality; not having a pecuniary interest.'" ***Id.*** at 5-6 (quoting ***Branco***, 148 So. 3d at 496 n.9).

The Sanders moved for a rehearing, which the court granted. The court then withdrew its original opinion and denied State Farm's petition because "the trial court did not depart from the essential requirements of the law because its order followed this Court's existing precedent in ***Rios v. Tri-State Insurance Company***, 714 So. 2d 547 (Fla. 3d DCA 1998) and ***Galvis v. Allstate Insurance Company***, 721 So. 2d 421 (Fla. 3d DCA 1998)." ***Id.*** at *2. ***Rios*** and ***Galvis*** both hold that a "direct or indirect financial or personal interest in the outcome of the [appraisal]" does not require the disqualification of an appraiser so long as the appraiser's financial interest is disclosed. ***Rios***, 714 So. 2d at 550; *see* ***Galvis***., 721 So. 2d at 421. The ***Sanders*** court, however, noted that its scope and standard of review was narrow because the issue was presented by a petition for writ of certiorari. The court stated, "[i]t is possible that our decision might be different had the question before us been presented by way of a plenary appeal." ***Id.*** at *5.

The court also acknowledged the express conflict between the Third District Court of Appeals' decisions of ***Rios*** and ***Galvis*** and the Fifth District Court of Appeal's decisions in ***State Farm Florida Insurance Co. v. Cadet***, 290 So. 3d 1090 (Fla. 5th DCA 2020) (holding that insured's public adjuster, who was under a contingency fee agreement, could not act as "disinterested" appraiser) and ***State Farm Florida Insurance Co. v. Crispin***, 290 So. 3d 150 (Fla. 5th DCA 2020) (holding that insured's appraiser, who was entitled to a ten percent contingency fee of any proceeds received in the same insurance claim, was not "disinterested"), and the decision of the Fourth District Court of Appeal in ***State Farm Florida Insurance Co. v. Valenti***, 285 So. 3d 958 (Fla. 4th DCA 2019) (holding that insured's public adjuster could not later be appointed as a "disinterested" appraiser based on his actions during the investigation of the claim and financial interest). Consequently,

it certified the following question directly to the Florida Supreme Court as one of "great public importance":

> CAN A FIDUCIARY, SUCH AS A PUBLIC ADJUSTER OR APPRAISER WHO IS IN A CONTRACTUAL AGENT-PRINCIPAL RELATIONSHIP WITH THE INSUREDS AND WHO RECEIVES A CONTINGENCY FEE FROM THE APPRAISAL AWARD, BE A **DISINTERESTED** APPRAISER AS A MATTER OF LAW?

Id. at *8 (emphasis added).[1] We now await a ruling from the Florida Supreme Court, which will have significant consequence on future insurance appraisals.

Courts in other jurisdictions have determined that a party's appraiser is not "disinterested" if he or she is frequently employed by the party as an appraiser or has a financial interest, even if indirect, in the outcome of the appraisal. For instance, in ***TAMKO Building Products, Inc. v. Factory Mutual Insurance Co.***, 890 F. Supp. 2d 1129 (E.D. Mo. 2012), the United States District Court for the Eastern District of Missouri found that the appraiser selected by Factory Mutual was "interested as a matter of law." ***Id.*** at 1140. The court based its decision on the fact that the appraiser asked Factory Mutual for advice on the umpire selection, submitted his draft presentation for the appraisal hearing to Factory Mutual for its review and edit, and sought approval from Factory Mutual about whether he should agree to the amount calculated by the umpire. The court also found that Factory Mutual's appraiser had a financial interest in the outcome of the appraisal although he was not receiving a contingency fee, based upon his "ongoing and future business prospects" with Factory Mutual, as demonstrated by the twenty-six (26) matters on which he previously worked for Factory Mutual, that his accounting firm's work for Factory Mutual constituted 4-7% of the accounting firm's annual income, that he had outstanding accounts with Factory Mutual totaling $940,000.00, and that he hosted dinners, lunches, and sporting events with Factory Mutual employees. ***Id.*** at 1141.

Other courts have focused on employment relationships between a party and its appointed appraiser in determining whether the appraiser should be considered "disinterested." *See* ***Tiger Fibers, LLC v. Aspen Specialty Ins. Co.***, 571 F. Supp. 2d 712, 717 (E.D. Va. 2008) (finding that under statute governing parties' appointment of disinterested appraisers to assess insurance losses, "the disinterestedness of a selected appraiser pertains only to the partiality of that appraiser for or against the specific parties in issue . . . only permanent employees of a party to the dispute, as contrasted with persons temporarily retained by the parties, lack the disinterestedness required by the statute."); ***Gebers v. State Farm Gen. Ins. Co.***, 38 Cal. App. 4th 1648, 45 Cal. Rptr. 2d 725 (1995)

[1] That same question was posed to the Florida Supreme Court by the Third District Court of Appeal in ***State Farm Fla. Ins. Co. v. Long***, No. 3D19-1593, 2020 Fla. App. LEXIS 11330 45 Fla. L. Weekly 1923 (Dist. Ct. App. 2020).

(finding that insurer-selected appraiser was not "disinterested" within the meaning of the statute based upon his direct pecuniary interest as an expert witness for insurer in two pending court actions). Therefore, depending on the jurisdiction, a prior or ongoing relationship between an appraiser and a selecting party may support a finding that an appraiser is not "disinterested."

2. Impartial

Some policies require that an appraiser is "impartial." Several recent decisions outline how courts evaluate an appraiser's "impartiality."

In ***Owners Ins. Co. v. Dakota Station II Condo. Ass'n***, the Colorado Supreme court interpreted the term "impartial" as used in an insurance policy's appraisal provision, finding that, based on the term's plain meaning, an appraiser must "be unbiased, disinterested, and unswayed by personal interest." 2019 CO 65, ¶ 1, 443 P.3d 47, 51. The court noted that an "impartial" appraiser cannot favor one side over the other or advocate on behalf of either party. The Colorado Supreme Court drew a distinction between advocating for a party and taking a position, explaining that an appraiser can defend his choice of methodology or use certain data, or explain why he or she disagrees with the other appraiser's methodology or selection of data, but he or she cannot simply seek to maximize the award for the party that retained him. The Colorado Supreme Court stated:

> [W]e acknowledge a distinction between advocating for a party and explaining a position. An appraiser can certainly explain her position without running afoul of the provision's impartiality requirement. An appraiser may, for example, defend her choice of methodology or use of certain data. Conversely, an appraiser may explain why she feels another appraiser's methodology or use of data is wrong. In neither instance would the appraiser necessarily be acting as an advocate *on behalf of* a party to the dispute. An appraiser advocates *for* or *on behalf of* a party when her actions are motivated by a desire to benefit a party. For example, if an appraiser simply seeks top dollar for a client, that is improper. In contrast, explaining a position or defending a choice in methodology can be motivated by a desire to reach an accurate outcome.

Id. 43 P.3d at 53 (emphasis in original). Based on this reasoning, the Colorado Supreme Court reversed the lower court's decision and remanded so the trial court could determine whether the appraiser's conduct conformed to this standard.

The court then addressed the issue of whether contingent-cap fee agreements that tie an appraiser's compensation to the ultimate appraisal award render the appraiser partial as a matter of law. Although "wary of the possible incentives these agreements create," the

Colorado Supreme Court declined to hold that contingent-cap fee agreements render an appraiser partial as a matter of law. On the particular facts of the ***Dakota Station II*** case, the court found that the appraiser's contingent-cap fee agreement (5% of the overall award) did not give her an impermissible financial interest in the outcome of the appraisal award because the final appraisal award was far in excess of the actual fees billed by the appraiser and the cap did not apply.

Other Colorado courts have disqualified appraisers and/or overturned appraisal awards based upon an appraiser's financial interest in the outcome of the insurance dispute and current or prior relationship with the selecting party. In ***Auto-Owners Ins. Co. v. Summit Park Townhome Assn.***, 886 F.3d 852 (10th Cir. 2018), a Colorado federal court entered an order requiring the mandatory disclosure of the parties' appointed appraisers, and holding that the appraisal process should proceed in accordance with the court's order. In that case, the court set aside the appraisal award that was 47% more than the amount claimed, finding that the insured's appointed appraiser was not impartial as required by the policy's appraisal provision based upon the extensive business relationship between the appraiser and the insured's counsel, which was intentionally misrepresented and undisclosed.

Likewise, in ***Axis Surplus Insurance Co. v. City Center West LP***, No. 2015 CV 30453 (Colo. Dist. Ct., Weld County Mar, 14, 2016), a Colorado state court disqualified the insured's appraiser because he had an extensive relationship with the firm representing the insured, was a business partner of the lawyers, advocated in support of positions taken by the firm, and socialized with the firm.

In Florida, an appraiser who has a financial interest in the outcome of the appraisal is often considered not impartial. ***Podolsky v. Federated National Insurance Co.***, 25 Fla. L. Weekly Supp. 530a (15th Cir. Ct. Palm Beach May 15, 2017). In ***Podolsky,*** the insureds hired a public adjuster to assist them with their claim. The public adjuster's contract provided that the insureds agreed to pay the public adjuster's firm "10% of the amount recovered, by adjustment or otherwise, due when paid by the insurance company." The insurer invoked appraisal under the policy's appraisal provision, which required that each party choose a "competent and impartial" appraiser. The insureds' public adjuster named himself as their appraiser. The insurer sent correspondence to the insureds stating that their public adjuster could not act as an impartial appraiser due to his financial interest in the outcome of the appraisal and requesting that the insureds name another appraiser. The insureds refused to name another appraiser. The insurer then denied the claim based on the insureds' failure to comply with the appraisal provision. Litigation ensued. The court in ***Podolsky*** relied on the dictionary definitions of "impartial" and "disinterested." As noted in the court's opinion, Black's Law Dictionary defines "impartial" as "not favoring one side more than another, unbiased and disinterested, unswayed by personal interest," and

"disinterested" as "free from bias, prejudice, or partiality ... not having a pecuniary interest in the matter at hand." Based upon these definitions, the court in ***Podolsky*** held that the selection of an "impartial" appraiser, as required by the policy, "mandate[d] that each party retain its selected appraiser who will be free from an interest in the amount [sic] the loss. An appraiser whose fee is based on the total amount of the loss has an interest in the amount of the loss, and therefore cannot be impartial."

The same reasoning was followed by the United States District Court for the Middle District of Florida in ***Nalcrest Foundation, Inc. v. Landmark American Insurance Company***, No. 8:18-cv-00996, 2018 WL 4293147 (M.D. Fla. July 27, 2018). In that case, the insurer filed a counterclaim for a declaration that the insured's appraiser was not "impartial," as required by the policy, based on the contingency fee agreement he had with the insured. The court denied the insured's motion to dismiss, holding that the insurer had pled sufficient facts to proceed with its claim to disqualify the insured's appraiser "because [the insured's appraiser's] compensation is directly correlated to the amount [the insured] recovers by virtue of the contingency fee agreement." ***Id.*** at *13-14.

Other courts have taken a more expansive view of impartiality. For instance, in ***Brickell Harbour Condo. Ass'n v. Hamilton Specialty Ins. Co.***, 256 So. 3d 245 (Fla. 3d DCA 2018), Florida's Third District Court of Appeal held that "impartiality" means something other than the "dictionary definition" when it concerns appraisers appointed and paid by the parties in the insurance context. According the court, the appraisal provision requires disclosure of an appraiser's "direct or indirect financial interest in the outcome of the [appraisal]" rather than disqualification of an appraiser. ***Id.*** at 249. Notably in that case, the challenged appraiser, who was an employee of a building consulting company often hired by the insurer, was never compensated directly by the insurer for any building consulting services provided by his company and was not compensated for his work on the appraisal on a contingency fee basis. His appointment was upheld by the court.

An Iowa appellate court held that appraisers do not violate their commitment to impartiality by acting as advocates for their selecting party. ***N. Glenn Homeowners Ass'n v. State Farm Fire & Cas. Co.***, 906 N.W.2d 204 (Iowa Ct. App. 2017). In that case, the insurer, in support of its position that the insured's appraiser was not "impartial," presented evidence that the appraiser testified in another proceeding that "he would say anything his client asked of him because that's how he got paid." ***Id.*** According to the court, this was not a sufficient showing of partiality to overturn the appraisal award.

C. CONCLUSION

To preserve the integrity of the appraisal process, the appointed appraisers must satisfy the qualifications required by the policy's appraisal provision: "competent and disinterested" or "competent and impartial." This is especially so since, in most cases, appraisal awards will be upheld. Although there is little dispute over what constitutes a

competent appraiser, there is increasing conflict over what constitutes a disinterested or impartial appraiser. The failure to appoint a disinterested or impartial appraiser could negatively affect the validity of an appraisal award, causing needless delay in the resolution of a claim.