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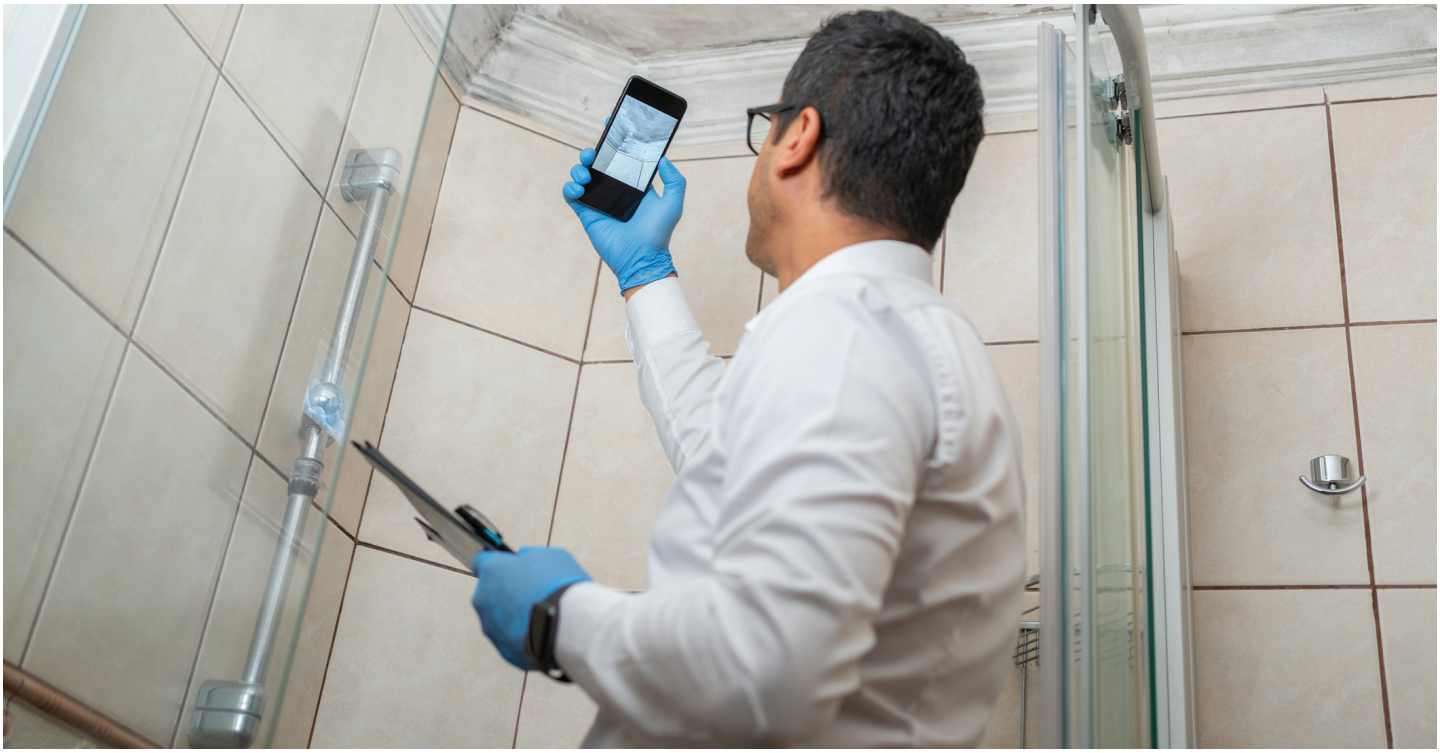

First-party insurance appraisals

WHY THEY ARE OFTEN AN EXPEDITIOUS WAY TO RESOLVE PROPERTY DAMAGE CLAIM DISPUTES

Recently, our offices spoke to a colleague handling a property insurance claim involving fire damage to a home. Our colleague reported that the homeowners' insurer was challenging the cost of repairing the damage, and the claim was stuck in neutral because of this ongoing dispute. Basically, the insurer claimed the damage would cost far less to repair than the insured said it would cost, and it was holding up payment. All the while, for several months, the insured had been effectively evicted from a damaged home while the parties' respective contractors argued over what it would cost to fix it up. This was a proverbial "battle of the experts" that, standing alone, was not bad faith. (See *Fraley v. Allstate Ins. Co.* (2000) 81 Cal.App.4th 1282, 1292-1293 [vast disparity between insured and insurer estimates is not bad faith in and of itself].)

Our colleague asked: How could the impasse be broken without surrendering to the insurer's lowball offer, or proceeding to costly and time-consuming litigation? To us, the answer was simple: Because the only true dispute was over the value of the damaged property and home, we advised our colleague to demand an insurance appraisal.

Our colleague gave a response that we hear quite often: "Ugh, I *hate* appraisal!" We could not help but smile. We often hear this from attorneys, time after time, once we recommend they take a property damage claim, or claim-related lawsuit, to appraisal. Attorneys from our offices are surprised there is such distaste for appraisals. After all, we *love* appraisals.

In our experience, appraisals are a more streamlined method of resolving – or, at the very least, simplifying – property damage insurance claims and lawsuits that, at their core, are just a dispute over what it will cost to fix the damage. We find that appraisals are an underutilized way of putting the price tag on claims – and, at times, lawsuits – in an efficient, low-cost manner. If properly

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used, appraisals offer less risk than litigation, without necessarily foreclosing a lawsuit. And, the duty of good faith and fair dealing still applies, so appraisals do not take bad faith out of the equation. If the insurer misuses appraisal to delay or underpay the claim, it is still on the hook for bad faith.

In effect, a properly utilized appraisal can let you have your cake and eat it, too. In writing this article, our goal is to explain what appraisals are, their benefits and limitations, and some of the pitfalls that can befall the unwary. If you know what you are doing, the appraisal process can help maximize your client's recovery.

What is an insurance appraisal, and what does it entail?

Under California Insurance Code section 2071, subdivision (a), all property insurance policies that cover fire damage in the State of California must include the following form policy language:

> **Appraisal**
>
> In case the insured and this company shall fail to agree as to the actual cash value or the amount of loss, then, on the written request of either, each shall select a competent and disinterested appraiser and notify the other of the appraiser selected within 20 days of the request. Where the request is accepted, the appraisers shall first select a competent and disinterested umpire; and failing for 15 days to agree upon the umpire, then, on request of the insured or this company, the umpire shall be selected by a judge of a court of record in the state in which the property covered is located. Appraisal proceedings are informal unless the insured and this company mutually agree otherwise. For purposes of this section, "informal" means that no formal discovery shall be conducted, including depositions, interrogatories, requests for admission, or other forms of formal civil discovery, no formal rules of evidence shall be applied, and no court reporter shall be used for the proceedings. The appraisers shall then appraise the loss, stating separately actual cash value and loss to each item; and, failing to agree, shall submit their differences, only, to the umpire. An award in writing, so itemized, of any two when filed with this company shall determine the amount of actual cash value and loss. Each appraiser shall be paid by the party selecting him or her and the expenses of appraisal and umpire shall be paid by the parties equally. In the event of a government-declared disaster, as defined in the Government Code, appraisal may be requested by either the insured or this company but shall not be compelled.

By statute, it is mandatory for the insurer to provide for appraisal: all policies in California covering the peril of fire, even in part, must be on the standard form. (See generally, Ins. Code, §§ 2070, 2071.) If other perils are covered by the policy, the standard form language need not be used *verbatim*, but the fire coverage offered must be substantially equivalent to the standard form, or more favorable to the insured than the standard form. (*Fire Ins. Exch. v. Superior Court* (2004) 116 Cal.App.4th 446, 459.) As a result, all property insurance policies covering fire must allow for appraisal with the same general rules.

A lot like arbitration

Appraisals are a form of arbitration. (*Louise Gardens of Encino Homeowners' Ass'n, Inc. v. Truck Ins. Exch., Inc.* (2000) 82 Cal.App.4th 648, 658.) In that vein, appraisals are generally subject to contractual arbitration law and its related statutory scheme. (*Lee v. California Capital Ins. Co.* (2015) 237 Cal.App.4th 1154, 1165.) However, appraisals differ from arbitrations in several key respects. For one, appraisals do not involve an arbitrator, but a group of professionals known as a "panel." (See generally, *Id.* at 1166-1167.)

To form a panel, each side must select a "competent and disinterested" appraiser to represent its interests and determine the "actual cash value" of the lost, damaged, or destroyed property. (Ins. Code, § 2071, subd. (a).) Thereafter, the designated appraisers must select a "competent and disinterested" umpire who basically serves as a neutral. The umpire guides the proceedings and, if the appraisers disagree over the cash value of any given item, decides which of the two numbers is correct. (*Ibid.*)

When the final number is determined, whether via agreement between the appraisers or ruling from the umpire, it is called an "award." (*Ibid.*) The "award" need not come in a specific form, as long as it separately itemizes the actual cash value of each item of lost, destroyed, or damaged property. (*Palma v. Watson Surplus Lines Agency, Inc.* (1957) 148 Cal.App.2d 879.) As with arbitrations, the panel's award can be "confirmed" via petition to the Superior Court, and thereby transformed into a judgment. (See *Klubnikin v. California Fair Plan Assn.* (1978) 84 Cal.App.3d 393, 398.) By the same token, the award can be vacated due to irregularities in the proceedings, or when the award exceeds the panel's authority. (See, e.g., *Kacha v. Allstate Ins. Co.*, 140 Cal.App.4th 1023, 1031 (2006); Code Civ. Proc. § 1286.2, subd. (a)(4).)

No issues of law are decided

To explain, unlike arbitrators, who can decide issues of law, appraisers have much more limited authority. Appraisers may only determine the "actual cash value" of the damaged or destroyed property in question. (Ins. Code, § 2071, subd. (a).) By statute, "actual cash value" means the lesser of: (a) the cost to repair or replace the thing lost or injured, minus a reasonable deduction for physical depreciation; or (b) the policy limit. (Ins. Code, § 2051; see also *California Fair Plan Assn. v. Garnes* (2017) 11 Cal.App.5th 1276, 1290-1295.) Consequently, the appraisal panel *may not* decide questions of law, (*Kirkwood v. California State Automobile Assn. Inter-Ins. Bureau* (2011) 193 Cal.App.4th 49, 62) interpret the policy or determine coverage, (*Kacha, supra*, 140 Cal.App.4th at 1034-1036

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[appraisal panel may not decide causation of damage or determine coverage in appraising value]), or decide questions of causation. (*Ibid.*)

By extension, the appraisal panel may not assign a value of zero to items because it disputes causation of damage. (*Lee, supra*, 237 Cal.App.4th at 1171-1173.) Nor may the panel assign a value of zero to items because it disputes the insured's identification of the property in question – rather than its quality or condition – as this arguably amounts to an accusation of fraud. (*Ibid; accord Safeco Ins. Co. v. Sharma* (1984) 160 Cal.App.3d 1060, 1066 [appraisal panel may not make factual determination that insured lost something other than what he claimed, rather than assessing value of the described items].) On the other hand, the panel *is allowed* to award nothing for items that are not damaged or never existed, provided that the nature or existence of the item is readily ascertainable. (*Lee, supra*, 237 Cal.App.4th at 1173.)

Because of these various limitations on the panel's authority, caselaw is replete with examples of appraisal awards that have been vacated because the panel's award exceeded its authority. (See, e.g., *Safeco Ins. Co. v. Sharma, supra*, 160 Cal.App.3d at 1066; *Kacha, supra*, 140 Cal.App.4th at 1035-1036, 1038.) To avoid such an outcome, courts recommend that the panel specify its rationale for awarding nothing on a given item in its award. (*Lee, supra*, 237 Cal.App.4th at 1173-1174.) Another potential workaround is to prepare an award form with various alternative valuations that specify, in writing, the assumptions underlying those valuations. (*Id.* at 1174-1175.)

In sum, appraisers are strictly intended to determine the actual cash value of an item claimed to be lost, damaged, or destroyed. Appraisers are not to decide questions of law, coverage, or causation. That is for future litigation if it is not resolved between the insurer and insured. Appraisers that exceed their authority in such a manner can and will have their ensuing award vacated. A properly worded award form and proper instructions to the panel can help to avoid this problem.

How to commence – or compel – an appraisal

As with arbitrations, appraisals can either commence via mutual agreement, or can be compelled via petition with the superior court. In either case, the process commences when the insurer or insured sends a written demand for appraisal. (Ins. Code, § 2071, subd. (a).)

However, the statutory language does not clearly state appraisals are mandatory. To illustrate, it contemplates the demand being "accepted" by the insurer or insured. (*Ibid.*) In our experience, insurers often decline appraisal, alleging that the claim is somehow unfit for it. In such circumstances, the remedy is to file a petition to compel appraisal in the superior court, and to cite certain cases suggesting that appraisal is mandatory. (See, e.g., *Lee, supra*, 237 Cal.App.4th at 1161, 1164-1165; *Doan v. State Farm General Ins. Co.* (2011) 195 Cal.App.4th 1082, 1093.) By statute, petitions to compel are only unavailable in "the event of a government-declared disaster, as defined in the Government Code." (Ins. Code, § 2071, subd. (a).)

Appraisals are also available to the parties during an ongoing lawsuit related to the underlying insurance claim. (*Kirkwood, supra*, 193 Cal.App.4th at 62.) In such circumstances, the trial court has the power to sever claims that are subject to appraisal, and either stay the appraisal or lawsuit pending the outcome of the other. (See, e.g., Code Civ. Proc., § 1281.2; *Doan, supra*, 195 Cal.App.4th at 1098; *Kirkwood, supra*, 193 Cal.App.4th at 62.) For example, courts often stay litigation to let the appraisal proceed and, if the panel's award assigns value to items that are subject to a coverage dispute, the litigation can be unstayed to decide any coverage questions that govern the insurer's obligation to pay the award. (*Lee, supra*, 237 Cal.App.4th at 1169; *accord Devonwood Condominium Owners Assn. v. Farmers Ins. Exch.* (2008) 162 Cal.App.4th 1498, 1507 fn.4.)

The appraisal process and its aftermath

Once commenced, appraisals are generally "informal" unless the parties agree otherwise. (Ins. Code, § 2071, subd. (a).) The default rule is that no formal discovery can be conducted, the rules of evidence do not apply, and a court reporter is not used. (*Ibid.*) However, an appraisal hearing may ensue if the amount in controversy is over $50,000. (Code Civ. Proc., § 1282.2.)

On the written request of either the insured or insurer, each must select a "competent and disinterested" appraiser and, within 20 days of the request, notify the other of the selection. (Ins. Code, § 2071, subd. (a).) Then, the appraisers must select a "competent and disinterested" umpire within 15 days: if they fail to do so, the court will make the selection upon the request of either party. (*Ibid.*)

The umpire must make the same disclosures to the parties as required of neutral arbitrators, including anything that could cause a reasonable doubt the umpire would be impartial: if the umpire fails to do so, it is grounds to vacate the ensuing award. (*Lambert v. Carneghi* (2008) 158 Cal.App.4th 1120, 1135.) However, the appraisers do not have the same disclosure requirements. To disqualify a party-appointed appraiser, there must be an objective showing of bias or prejudice. (*Mahnke v. Superior Court* (2009) 180 Cal.App.4th 565, 577-578.) For example, an award can be set aside if an appraiser has an ongoing financial relationship with its employing party, creating the "impression of possible bias." (*Gebers v. State Farm Gen. Ins. Co.* (1995) 38 Cal.App.4th 1648, 1652.)

Once the appraisers and umpire are selected, each party pays for its own appraiser, while the expenses of appraisal and the umpire's fee are equally shared. (Ins. Code, § 2071, subd. (a).) Generally, the two appraisers attempt to agree on the cash value, and submit any differences to the umpire for resolution. (*Ibid.*) As

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long as two of the three – i.e., both appraisers, or one appraiser and the umpire – reach agreement on the cash value, they issue an award form, in writing, separately stating the cash value and loss as to each item. (*Ibid.*)

After the award has been issued, it is treated like an arbitration award and, as such, becomes an enforceable judgment upon petition to the superior court to be confirmed. (See *Klubnikin*, *supra*, 84 Cal.App.3d at 398.) The petition to confirm the award must be filed within four years after the signed award is served. (Code Civ. Proc., § 1288.) More importantly, service of the award also triggers a 100-day deadline to file a petition to vacate or correct the award. (*Ibid.*) If such petition is not filed within the 100-day window, the award becomes final, and may not be challenged by collateral attack except for those grounds available to attack any civil judgment. (*Klubnikin*, *supra*, 84 Cal.App.3d at 398.) Accordingly, time is of the essence in challenging an appraisal award. If you fail to do so and the award becomes final, you will have few, if any, tools available to challenge it.

Bad faith and appraisals

Although the covenant of good faith and fair dealing requires insurers to pay all undisputed claims without delay, insurers often misuse the appraisal process to delay payment of undisputed claims. (See, e.g., *Maslo v. Ameriprise Auto & Home Ins.* (2014) 227 Cal.App.4th 626, 633-634 (*Maslo*); *accord Brehm v. 21st Century Ins. Co.* (2008) 166 Cal.App.4th 1225, 1241-1242.) In our experience, insurers do this by challenging every item presented by the insured, without cause for the challenge. This causes the matter to drag out, often for over a year, until the appraisal panel awards a number close to, if not equal to, the insured's estimate presented to the insurer *prior to* appraisal.

In such circumstances, the law does not absolve the insurer from bad faith simply because the claim went to appraisal. To illustrate, in *Maslo*, the insured made a policy limits uninsured motorist claim with his insurer after he was injured by the negligence of an uninsured motorist. The police determined the uninsured motorist was the sole cause of the accident, and the insurer received a copy of the police report at the outset of the claim. (*Maslo*, *supra*, 227 Cal.App.4th at 630.) Despite the insured providing his medical records and billing statements, and a request for the policy limits, the insurer did not respond – and, after the insured renewed his request, the insurer asked for an extension and demanded an arbitration. (*Id.* at 630-631.)

During the 21 months that elapsed between the arbitration demand and the arbitration itself, the insurer did not schedule the depositions of the plaintiff's treating physicians or interview them. (*Id.* at 631.) The insurer also did not request a medical examination or medical review. At the arbitration, the insured was awarded a six-figure sum that was less than the policy limits, but far more than the insurer's offer of nothing.

The appellate court reversed a judgment of dismissal at the pleading stage, finding the plaintiff had stated a claim for insurance bad faith. The court explained that an insurer's right to resolve a disputed claim through arbitration does not relieve it of its statutory and common law duties to fairly investigate, evaluate, and process a claim. The court also noted that where there is no genuine dispute arising from such investigation and evaluation, the insurer may not escape liability for bad faith simply because the amount ultimately awarded in arbitration was less than the policy limits or the initial demand. (*Id.* at 630, 636-637.)

Along similar lines, in *Brehm v. 21st Century Ins. Co.* (2008) 166 Cal.App.4th 1225, 1230-1231, the plaintiff was injured by the negligence of an underinsured motorist. After settling with that motorist's carrier, the insured still had a severe shoulder injury, and made a claim for his $90,000 policy limits, citing an examination by an independent orthopedic surgeon. After arbitration concluded, the insured received the policy limits.

Here, too, the appellate court reversed a judgment of dismissal at the pleading stage, finding that even if there was no express breach of a contractual provision, bad faith liability still could be found. (*Brehm*, *supra*, 166 Cal.App.4th at 1237.) The court explained that although the insurance policy gave an absolute right to demand arbitration, this right included an implied obligation to honestly assess the claim and make a reasonable effort to resolve any dispute before invoking that right. (*Id.* at 1242.)

PI bad-faith principles also apply to property damage

While these cases involve arbitration of first-party *personal injury* claims, their principles also apply to property damage appraisals. As such, our offices regularly bring bad-faith claims against insurers who misuse the appraisal process to delay payment of claims that were never truly subject to dispute.

To illustrate, our offices recently obtained an appraisal award valued at about *40 times* what the insurer offered before the appraisal. In and of itself, this disparity suggested the insurer had acted in bad faith. Even worse for the insurer, it had only paid this award after dragging the claim through appraisal for over a year, baselessly challenging every item in the award. All the while, the insured had continued to incur living expenses from a substitute home, yet the insurer refused to pay for those amounts, citing the appraisal proceedings.

When the award was finally issued, the panel determined the time to repair the property was four months, and the insurer paid that sum. We asked the insurer to pay the additional living expenses that had accrued in the preceding year, noting that the panel's award was strictly for building repairs, and did not include the many months when the insurer baselessly dragged out the appraisal to delay payment. The insurer refused, and a bad-faith lawsuit ensued.

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However, judges often confuse post-appraisal lawsuits as disallowed collateral attacks on the underlying appraisal award. (See *Klubnikin, supra*, 84 Cal.App.3d at 398.) To avoid such confusion, the language of the award form is *critical*. In our recent experience, defense attorneys have been drafting award forms that either use the express policy language, or related terms of art, to describe portions of the award. If such an award is confirmed, it will hamstring a future lawsuit for bad faith because the Court will be much more likely to see it as a collateral attack on the award.

For example, we find that this phenomenon arises in appraisals where, due to a property becoming uninhabitable or otherwise unavailable for use, the insured incurs additional living expenses, lost rental income, and/or lost business income. These forms of insurance have a time-element limitation to determine what is owed to the insured: e.g., the "shortest time to repair or replace the property," or the "period of restoration" for the property. Even though appraisers are not allowed to interpret the policy or determine coverage, insurers routinely attempt to have them do this by drafting an award form that uses the policy language, or related terminology.

Do not fall for this! The language of the award form can be negotiated between the insurer and insured. If the insurer refuses to play ball, you can object to this language – ideally, it will suffice for the panel to reject it. However, if the panel proceeds with that improper language, you have the backup option of a petition to vacate or modify the award.

Conclusion

To most attorneys, a property insurance appraisal is a completely foreign concept. As a result, appraisals are woefully underused and underappreciated. We are hopeful that, after reading this article, attorneys will be more willing to attempt resolution via appraisal. Not only are appraisals usually faster and cheaper than litigation, but a properly utilized appraisal still leaves behind the option of litigation after the award is paid. If you have additional questions pertaining to insurance appraisals, please do not hesitate to contact the authors for advice.

Alexander Cohen is a founding partner of ACTS Law, *where he represents individuals, business and commercial property owners in residential and commercial property damage losses throughout the United States. He properly navigates the claims and recovers insurance benefits for his clients, particularly when claims have been underpaid or denied. Mr. Cohen has developed a reputation among insurance companies and defense counsels as an expert in insurance law and coverage.*

David Bederman is a member of the American Association of Justice (AAJ). He has also been named as a Super Lawyers "Rising Star" in 2020 and 2021. Mr. Bederman graduated Order of the Coif from Loyola Law School in Los Angeles in 2012. While in law school, David served as a Senior Technical Editor of the Loyola Law Review, and a judicial extern for the Hon. Gary Allen Feess of the United States District Court for the Central District of California.