# CORRUPTION OF THE APPRAISAL PROCESS

**INSURERS NEED TO RESOLVE COVERAGE AND FRAUD ISSUES BEFORE SUBMITTING DISPUTES TO APPRAISAL.**

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## THE LAW GOVERNING APPRAISALS IN CALIFORNIA AND OTHER STATES:

Fire Insurance policies have long been required to use standard policy provisions. They provide that, when the insured and insurer fail to agree as to the actual cash value or amount of a loss, they must participate in an appraisal. Each party selects a competent and disinterested appraiser, who together select (or the court appoints) a competent and disinterested umpire. The party-appraisers appraise the loss and, in the event of disagreement, submit their differences to the umpire. Courts have enforced appraisal clauses in fire insurance policies for a hundred and twenty five years. (See *Old Saucelito Land & Dry Dock Co. v. The Commercial Union Assurance Co.*, 66 Cal. 253 (1884).)

Code of Civil Procedure § 1280, which governs the conduct of arbitrations, provides that agreements to arbitrate include valuations and appraisals. (*Coopers & Lybrand v. Schwartz*, 212 Cal.App.3d 524, 534 (1989).) An appraisal is an arbitration and, prior to 2001, appraisals were subject to arbitration provisions regarding subpoenas, depositions, and document discovery. A court reporter could transcribe testimony.

In 2001, in response to complaints of alleged insurer abuses following the 1991 Oakland fire and the 1994 Northridge earthquake, the legislature inserted the following language into the Standard Policy's Appraisal paragraph:

> *"Appraisal proceedings are informal... 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." (Ins. Code § 2071.)*

As a result, the procedures governing appraisals have been significantly changed and adjusters and defense counsel should change their practices accordingly.

## THE "APPRAISAL CLUB":

The name "Appraisal Club" was coined by this author to describe a group who have formed a clique to dominate appraisal procedures in California and other states. Some Appraisal Club members were drawn to California by the Northridge earthquake. The legislature was persuaded to extend the limitations on claims arising out of that 1994 event, and litigation of claims continued five years into the 21st Century. Appraisal Club members can be identified by their disclosure statements. He will have alternately served as an appraiser, umpire, or expert in hundreds of appraisals with other members in the alternate positions. If he is a party-appraiser, he names another club member as umpire or calls them to testify as experts – thereby insuring members full employment. These "experts," who have no personal knowledge of the loss, argue the award must be based on pricing provided by the "unchallengeable" computer program, Xactimate, even though an item can clearly be replaced for less than that set by Xactimate personnel in Orem, Utah. (Xactimate is a widely used efficient program; but "garbage in, garbage out" applies to any computer program.) Appraisers are to fix the amount of loss based on their own skill and expertise – not that of a computer program.

### THE EXPANDING AND EVOLVING CLAIM:

Appraisals conducted by Appraisal Club members expand during the process. New claims appear. Why? Because the Adjuster failed to pin down the extent of the claimed loss prior to the appraisal. When an Appraisal Club member values a simple claim for interior water damage, a need for extensive emergency services, code upgrades, additional living expenses, and loss of income is triggered. They argue that, under *Kacha v. Allstate Ins. Co.*, 140 Cal.App.4th 1023 (2006) the appraisers must value all the insured's claimed damages and accept the insured's description of the quality and quantity of damaged items. A $150,000 claim, evolves to $450,000; and, when a $300,000 award is made, the appraiser claims he saved the insurer a lot of money.

What can be done to prevent an expanding claim? First, obtain a Proof of Loss and the insured's definitive estimate of the claim ***prior*** to appraisal submission. Don't allow the insured to submit several estimates without identifying which one constitutes the claim. An insurer's appraisal demand should clearly state the extent of the dispute. Seek an umpire ruling that new estimates and evidence may not be submitted during appraisal. Make sure photographs are digitally dated.

### APPRAISE THE ENTIRE LOSS:

What about line items the Adjuster agreed to pay before the appraisal? Insureds argue the right to dispute value of items the insurer agreed to pay is waived. Contractors' bids are higher on small projects. The fair market value of a portion of a loss is extremely difficult to accurately determine. Policy provisions require appraisers to "appraise the loss." They do not contemplate appraising only the disputed portions.

### APPRAISAL SCOPE IS LIMITED TO DETERMINING THE VALUE OF A LOSS:

An arbitration encompasses questions of fact and law; but appraisers only have power to determine questions of fact, namely the actual cash value and replacement cost of the claimed loss. (*Jefferson Ins. Co. v. Superior Court*, 3 Cal.3d 398 (1970).) Appraisals are not designed to resolve issues of coverage or causation, and insurers should ask themselves, "Is this really a dispute over value?" In a dispute over value, the Adjuster believes the insured inflated the loss and the insured believes the Adjuster is "low-balling" it. The line between over-valuing, under-valuing and fraud and "bad faith" is fine.

### APPRAISAL IS NOT THE PLACE TO CONFIRM SUSPICIONS OF FRAUD:

The fact that a fraudulent claim should not be submitted to appraisal is heightened by the 2001 changes emphasizing informality, eliminating discovery and prohibiting court reporters. The insured may tell lies to explain questionable aspects of the claim, and there is no record of the falsehoods.

As stated in *Safeco Ins. Co. v. Sharma*, 160 Cal.App.3d 1060, 1066 (1984):

> *"When an insurer disputes an insured's description in identification of the lost or destroyed property, it necessarily claims the insured misrepresented – whether innocently or intentionally – the character of the loss… this claim opens the door to allegations of fraud. Were an insurer permitted to include the former issue within the scope of an appraisal, a determination in the insurer's favor would foreclose a court from determining…fraud in any subsequent litigation."*

Appraisal Club members expand *Sharma* to mean appraisers must accept every claim an insured makes regarding the loss. But, *Sharma* involved a claim that stolen paintings were a matched set. Appraisers did not have access to them to make that determination. *Sharma* does not mean that appraisers must accept the insured's claims about the condition and quality of items when the items involved are available to view.

### ISSUES OF FRAUD AND COVERAGE SHOULD BE RESOLVED PRIOR TO APPRAISAL:

The Court of Appeal recently held in *Kirkwood v. California State Automobile Association Inter-Insurance Bureau*, 193 Cal.App.4th 49, 63 (2011) that an appraisal was properly deferred until the insured obtained a court declaration as to whether the insurer improperly applied blanket depreciation based on the item's age without regard to condition. The *Kirkwood* court said, "judicial economy favors resort to declaratory relief" as to questions of coverage before appraisal. It "heads off duplicative future actions." *Kirkwood* equally supports an insurer's request to defer appraisal until coverage and fraud issues are determined.

### THE IMPORTANCE OF THE LANGUAGE OF THE AWARD:

*Devonwood Condominium Owners Ass'n v. Farmers Ins. Exchange*, 162 Cal.App.4th 1498 (2008) illustrates the importance of the language of an award when coverage is in dispute. An appraisal panel's authority is limited to the amount of a loss, coverage is left to the court. The dilemma for the appraisal panel is how to resolve valuation issues without impinging on the court's authority to determine coverage. The *Devonwood* appraisal was complicated by Farmers' claim it did not cover interior painting, while the association maintained it did. The appraisers set forth two categories of replacement cost – one exclusive of interior painting and one for the painting, stating the award was made without consideration of any coverage or other policy provision which might affect the insurer's liability. The court confirmed the award and entered a money judgment for the combined value of the two categories. The court of appeal reversed, holding the money judgment did not conform with the appraisal award and the court lacked authority to enter it. The appraisers expressly acknowledged they were not resolving coverage questions, and, without a determination of coverage, the money judgment was invalid.

### IN CONCLUSION:

- Deny claims that are clearly not covered.
- If a claim is suspect, have the insured examined under oath.
- Don't use appraisals to determine coverage or prove fraud.
- Seek deferral of appraisal until a judicial determination of coverage and/or fraud is obtained.
- Establish the extent and scope of the claim before an appraisal, and define values in dispute.
- Look carefully at your party-appointed appraiser's affiliations and disclosure statement.
- Obtain an itemized award that identifies the value assigned to disputed line items and contains the appraiser's disclaimer of consideration of coverage and pertinent issues.

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