Insurance Rulings Continue Expansion Of Appraisal's Ambit

By **Matthew Fortin** (October 10, 2023)

Matthew Fortin

In Illinois, as elsewhere, property insurance policies allow certain limited disagreements that arise during the adjustment of a claim to be resolved through a process known as appraisal. Unlike arbitration, appraisal is an informal procedure limited by its terms to resolving disagreements over the "amount of loss."

Provided the parties' dispute concerns the amount of loss, a demand for appraisal requires each party to select a competent and impartial appraiser who, in turn, select an umpire. The appraisers are tasked with separately stating the amount of loss. If they fail to agree, they must submit their differences to the umpire.

A decision agreed to by any two members of the appraisal panel is binding on the parties as to the amount of loss. In some instances, the appraisal provision may contain a reservation of rights whereby the insurer, despite the appraisal, retains the right to deny the insured's claim.

The threshold question when a party demands appraisal is whether the disputed issue falls within the scope of the appraisal clause. By its terms, the appraisal clause is only available to resolve disagreements over the value of property or the amount of loss.

Courts have long recognized that the traditional purview of appraisal is to make value determinations. Illinois' appellate courts have accordingly consistently refused to compel appraisal of disputes that turn on the scope of coverage afforded by an insurance policy or the interpretation of its terms.[1]

In recent years much litigation, especially in Illinois, has concerned whether, and, under what circumstances, causation issues are part of the amount of loss within the purview of the appraisal panel or, alternatively, are coverage issues reserved for the courts.

Within one week at the end of August, the U.S. District Court for Northern District of Illinois issued the latest of many opinions on the subject, Wysoczan v. Cambridge Mutual Fire Insurance Co.,[2] while the Illinois Fifth District Appellate Court became the first Illinois appellate court to weigh in on the issue in Shelter Mutual Insurance Co. v. Morrow.[3]

Wysoczan v. Cambridge

Wysoczan involved a claim for structural damage to an enclosed porch allegedly caused by ice formation and damming. Cambridge denied coverage for the alleged structural damage but paid to clean and paint interior surfaces that were damaged by melt water.

The insured filed suit in the Northern District of Illinois, hoping to be the latest beneficiary of that court's willingness to compel appraisal where the parties' dispute extends to the cause and extent of damage to insured property. The court did not disappoint.

Noting that neither the Illinois Supreme Court nor the state's appellate courts had addressed whether causation issues are subject to appraisal, the court held, on Aug. 28, that causation issues may be resolved in appraisal because determining the cause and

extent of damage to insured property is an inherent part of determining the amount of loss.

The court acknowledged a line of Illinois appellate court cases holding that coverage issues and policy interpretation are beyond the scope of appraisal,[4] but found them of little value because they only stood for the limited and uncontroversial principle that "disputes that turn on legal questions about contract interpretation" are not subject to appraisal.

That rule is sensible, the court noted, because "appraisers are typically neither lawyers nor judges and thus should not be asked to settle questions that require legal expertise."[5] But, the court continued, "[n]othing from th[o]se cases suggests that appraisers are unable to settle purely factual questions about the cause of physical damage."[6]

The court reconciled its interpretation of the scope of the appraisal process with the language in the appraisal provision stating that "[i]f there is an appraisal, [Cambridge] will still retain our right to deny the claim"[7] by limiting that reservation of rights to "object[ions] to whether the insured's claim is the type of claim that is covered at all."[8]

The court did not elaborate on what it meant by "the type of claim that is covered at all," except to explain that the retained right-to-deny did not extend to objections based on the cause of damage.[9]

Thus, the court not only held that the cause and extent of damage to the insured's porch could be determined in appraisal, it also deprived Cambridge of the right to enforce any causation-based exclusions in the insurance policy.

Shelter v. Morrow

Morrow involved a claim for hail and wind damage to the insured's home. Shelter acknowledged limited damage to the roof caused by wind but estimated the cost of repairs at below the deductible.

Shelter maintained that other damage observed on the roof was unrelated to wind and, instead, was attributable to one or more excluded causes of loss. Shelter refused the insured's demand for appraisal and sought a declaratory judgment in an Illinois state court seeking a ruling that the appraisal clause did not apply to the parties' dispute.

The court denied Shelter's motion and ordered the parties to appraisal. Sheltered appealed, and the Fifth District Court of Appeal affirmed on Aug 24.[10]

On appeal, Shelter argued that an appraisal panel's authority is limited to determining the dollar value of covered damage, and does not include determining the existence or extent of covered damage.

The court disagreed under the facts presented, noting that Shelter's adjuster acknowledged there were collateral indicators the insured property had been subjected to significant wind speeds on the claimed date of loss and had prepared an estimate of the cost to repair the covered damage.

"[B]ased upon these facts alone," the court explained, "it is evident that the question at issue is not whether a covered loss occurred because a covered loss was found by Shelter's own adjuster in its report. Instead, the true dispute ... is the amount of that covered loss."[11]

Discussion

Wysoczan is the latest in a long line of opinions to come out of the Northern District of Illinois in the last decade finding that, when an insurer admits the existence of a covered loss, determinations regarding the cause or causes of damage to the property, and even when any such damage occurred, are part of the amount of loss, which may be conclusively determined through appraisal.[12]

Morrow, meanwhile, is the first Illinois appellate court to address whether causation issues may be resolved in appraisal.

Morrow essentially stands for the proposition that when a carrier admits that insured property was damaged by a covered peril, disputes regarding the extent of that damage and the cost to repair or replace it may be resolved through appraisal.

Notably, Morrow is an unpublished order issued under Illinois Supreme Court Rule 23, meaning that litigants can cite it for its persuasive value, but it is not binding precedent on circuit courts. As a result, Morrow's persuasive value is limited to circumstances where an insurer has acknowledged that insured property has sustained damage from a covered peril.

While Morrow did not draw on the earlier Illinois appellate court cases that held coverage disputes and policy interpretation were beyond the scope of appraisal, its analysis is arguably consistent with the framework established by those earlier cases. Namely, a court that is asked to compel appraisal of an insurance dispute must determine whether the language of the appraisal clause is clear and unambiguous and, if so, may only compel appraisal when it is obvious that the disputed issue falls within the scope of the clause.[13]

The same cannot be said of Wysoczan. The court did acknowledge the body of earlier Illinois appellate cases interpreting appraisal provisions but, like the other rulings from the Northern District of Illinois that came before it, Wysoczan took no guidance from them because they did not address whether causation could be subject to appraisal.[14]

While those cases did not answer the exact question posed to the court in Wysoczan, they nevertheless provide ample guidance as to how the Illinois Supreme Court would approach the issue. In each instance, those courts applied an analytical framework that led them to clearly and consistently interpret appraisal provisions narrowly in recognition of the specific language used — "amount of loss."

As a federal district court sitting in diversity jurisdiction applying Illinois law, that is exactly what the court should heed under the 1938 U.S. Supreme Court case Erie Railroad Co. v. Tompkins.

Instead of taking guidance from these Illinois appellate court decisions, Wysoczan and the other district court decisions that blazed the same trail abandoned that framework. Instead of determining whether the phrase "amount of loss" in the appraisal provision clearly and obviously signaled the parties' intent to submit causation disputes to appraisal, those courts started from the premise that issues of coverage, liability and policy interpretation are legal issues reserved for judicial determination while everything else, essentially, is a factual issue subject to appraisal.[15]

Importantly, that framework is not concerned with whether a given dispute concerns the "amount of loss," in which case it is an appropriate subject for appraisal. Instead, the determining factor appears to be whether a given dispute is one which the court expects

appraisers will be qualified to handle.[16]

Indeed, that is the lens though which Wysoczan viewed the line of Illinois appellate court cases refusing to compel appraisal of disputes that hinged on the scope of coverage or policy interpretation.

Those cases, according to Wysoczan, "stand only for the proposition that appraisers are typically neither lawyers nor judges and thus should not be asked to settle questions that require legal expertise."[17] In contrast, "[n]othing from th[o]se cases suggests that appraisers are unable to settle purely factual questions about the cause of physical damage."[18]

As a result, the outcome in Wysoczan does not so much reflect the court's conclusion that the parties intended the appraisal panel's authority to include reaching a binding determination as to whether the insured's porch sustained structural damage due to ice formation and damming and, if so, the nature and extent of that damage.

Instead, the driving force for the court's holding seems to be that appraisers are capable of determining whether the porch sustained structural damage and nothing in the appraisal clause forbids them from doing so.

None of this is to say that courts are wrong to find that the appraisal provision authorizes appraisers to address causation issues in the course of determining the amount of loss. To be sure, there is some logic to permitting appraisers to consider causation.

If appraisers were strictly prohibited from determining for themselves whether and to what extent the insured property was damaged by a covered peril, appraisal would only be available in the rarest of circumstances, i.e., where the parties agree on the cause and extent of damage and only disagree on how much it will cost to repair or replace that damage.

But what Morrow, Wysoczan and other cases permitting appraisers to determine the cause and extent of damage fail to consider is that while appraisers, at least in some instances, must necessarily make determinations regarding the cause of damage in order to determine the amount of loss, the language of the typical appraisal provision only states that the amount of loss set by the appraisers will be binding; it says nothing about the cause or causes of damage.

Courts can empower appraisers to make what causation determinations they must in order to set the amount of loss, while leaving room for judicial review of those determinations. The appraisal panel's determination of the amount of loss would be binding, but the conclusiveness of the appraisal panel's causation determinations could depend on the nature of the loss at issue, the parties' dispute, and the form of the appraisal award.[19]

In fact, the language in the appraisal clause stating that the insurer reserves the right to deny the claim in the event of an appraisal serves precisely that purpose.[20]

Neither Wysoczan nor Morrow endorse this approach. Morrow is silent as to whether Shelter could challenge causation determinations made by the appraisal panel. Wysoczan, on the other hand, explicitly foreclosed the possibility of challenging causation determinations made by the appraisal panel by interpreting the right-to-deny clause in the appraisal provision as only permitting an insurer to deny a claim following appraisal on grounds other than causation.

But the case the court cited as supporting its interpretation, a Northern District of Illinois decision from 2013, CenTrust Bank NA v. Montpelier U.S. Insurance Co., read the same right-to-deny provision in a similar appraisal clause "to mean that the insurer may still object to liability, but cannot object to the amount assessed by the appraisal process."[21] CenTrust, then, appears to leave room for post-appraisal causation challenges.

Ultimately, until Illinois' appraisal jurisprudence returns to a principled framework whereby the scope of appraisal is limited to those issues specifically enumerated in the appraisal clause, i.e., the value of the property or amount of loss, or room is given for insurers to raise policy-based defenses outside the amount of loss, Morrow, Wysoczan and their ilk will diminish the usefulness of appraisal for its original purpose and leave the process open to abuse.

As the scope of appraisal expands under Illinois law, it will grow increasingly unrecognizable from the simple, inexpensive and efficient method for resolving valuation disputes that it once was.

When appraisers are tasked not only with determining the cost to repair or replace damaged property, but also with determining the cause or causes of damage, and when damage occurred, they will have to increasingly rely on engineers, meteorologists and other experts to inform their judgment. The universe of information relevant to the issues before the appraisal panel will also increase, including records of pre-loss repairs, photographs and other materials.

The result will be a slower, more expensive and cumbersome process that resembles litigation more than it does an informal, inexpensive and efficient means of dispute resolution.

In the meantime, it is increasingly important for practitioners to do everything they can before appraisal to put their clients in the best position to protect their contractual rights after appraisal.

That may mean securing the parties' and appraisal panel's agreement to a memorandum setting forth the scope of the appraisal and protocols for inspections and the exchange of information; specifying the form of the appraisal award to allow the parties to identify and, if appropriate, contest specific portions of the award without invalidating the award in its entirety; and otherwise ensuring that the appraisers have the information and access to resources they need to complete the task they've been given.

Matthew P. Fortin is a partner at BatesCarey LLP.

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[1] See, e.g., FTI Int'l Inc. v. Cincinnati Ins. Co., 339 Ill. App. 3d 258 (2nd Dist. 2003) (holding that whether policy required insurer to pay replacement cost or sales price was

outside the scope of appraisal); Kinkel v. Cingular Wireless LLC, 357 Ill. App. 3d 556, 560 (5th Dist. 2005) ("The appraisal process itself is not designed to answer questions of contract interpretation"); Lundy v. Farmers Group Inc., 322 Ill. App. 3d 214, 219 (2d Dist. 2001) (holding that a dispute about whether the insurer misrepresented its insurance policy could not be settled through appraisal because it "require[d] an interpretation of the policy language, in particular the phrase kind and quality").

[2] Wysoczan v. Cambridge Mutual Fire Insurance Company, No. 1:23-CV-00905, 2023 WL 5530535 (N.D. Ill. Aug. 28, 2023).

[3] Shelter Mutual Insurance Company v. Morrow, 2013 IL App (5th) 230249-U (Aug. 24, 2023).

[4] See, e.g., n. 1, supra.

[5] 2023 WL 5530535, at *4.

[6] Id.

[7] Id. at *2.

[8] Id. at *5.

[9] Id.

[10] 2023 IL App (5th) 230249-U, ¶¶ 1-2.

[11] Id. at ¶ 19.

[12] See, e.g., B&D Investment Grp. LLC v. Mid-Century Ins. Co., 2021 WL 6125853 (N.D. Ill. Dec. 28, 2021) (compelling appraisal where insurer admitted hail damage to metal vents but denied that roof itself had been damaged by hail); Khaleel v. Amguard Ins. Co., 2022 WL 425733, at *3 (N.D. Ill. Feb. 11, 2022) ("Because defendant has acknowledged that some portion of the dwelling was damaged by hail and constitutes a covered loss, this instant suit is not a coverage dispute but a dispute over the amount of loss."); Spring Point Condo. Ass'n v. QBE Ins. Corp., 2017 WL 8209085 (N.D. Ill. Dec. 13, 2017) (compelling appraisal of storm damage claim where parties disputed whether damage occurred prior to the policy period or during it).

[13] See, e.g., Travis v. Am. Mfrs. Mut. Ins. Co., 335 Ill. App. 3d 1171 (5th Dist. 2002); FTI Int'l Inc. v. Cincinnati Ins. Co., 339 Ill. App. 3d 258, 260 (2nd Dist. 2003) (noting that in order to compel appraisal "the dispute must be of a sort that the parties intended would fall within the scope of the appraisal process.").

[14] See Spring Point Condo. Ass'n, 2017 WL 8209085, at *3 (explaining that FTI Int'l and related cases only applied to disputes about contractual interpretation).

[15] Wysoczan, 2023 WL 5530535, at *3-6; Culvey v. Auto-Owners Ins. Co., --- F. Supp. 3d ---, 2023 WL 3074344, at *2 (N.D. Ill. Apr. 25, 2023); River Grove Plaza Inc. v. Owners Ins. Co., 2022 WL 16782412, at *2 (N.D. Ill. Nov. 8, 2022).

[16] See 70th Court Condo. Ass'n v. Ohio Sec. Ins. Co., 2016 WL 6582583, at *4 (N.D. Ill. Nov. 7, 2016) ("appraisers are generally expected to act on their own skill and

knowledge."); Runaway Bay Condo. Ass'n v. Phila. Indem. Ins. Co., 262 F. Supp. 3d 599, 601 (N.D. Ill. 2017) (holding that appraisers may determine causation, and noting that insurer failed to "provide any reason for thinking that determinations regarding causation are beyond the appraiser's ken." Appraisers could also determine whether repairs required the services of a general contractor where the insurer "offer[ed] no basis for thinking that appraisers lack the competence to address the question of whether a contractor is necessary").

[17] Id. at *4.

[18] Id.

[19] See North Glenn Homeowners Ass'n v. State Farm Fire & Cas. Co., 854 N.W.2d 67 (Iowa Ct. App. 2014).

[20] Phila. Indem. Ins. Co. v. WE Pebble Point, 821 (S.D. Ind. 2014) (explaining that right-to-deny language in appraisal provision "expressly provides that the insurer may deny the claim notwithstanding the appraisal results – presumably by interposing defenses derived from elsewhere in the contract, such as 'uncovered' causes of loss."); Westview Village v. State Farm Fire & Cas. Co., 2022 WL 3584263, at *4 (N.D. Ohio Aug. 22, 2022) ("Courts that allow appraisal to determine causation typically permit insurers to contest coverage and assert defenses after appraisers set the amount of loss.")

[21] CenTrust Bank, N.A. v. Montpelier U.S. Ins. Co., 2013 WL 1855838, at *2 (N.D. Ill. May 1, 2013).