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Appraisal in North Carolina—Dead or Alive?

by L. Lamar Armstrong, Jr. and L. Lamar Armstrong, III

Although appraisal had existed in North Carolina for over a century,[1] it was largely dormant until hurricanes in the 1980's and 1990's caused widespread damage. Appraisal experienced resurgence, becoming an effective, efficient, and inexpensive procedure to resolve first party property claims.[2] Appraisal was never judicially equated to arbitration. However, in practice, it was a quasi-arbitration which established a binding award easily enforceable against insurers. Appraisal was alive and well.

Based on the *Hailey* and *Sadler* cases explored in this article, appraisal is now a quite different process that requires compliance with post-loss duties and an earlier and more detailed focus on causation between the covered peril and the damage claimed. We must use *Hailey* and *Sadler* to force insurers to address damages and causation with requisite detail. When insurers fail to promptly, honestly, and completely respond, and they play games to avoid appraisal by creating false disputes over value or causation, they will provide ammunition for unfair claims settlement practice (UCP) claims.[3]

General Overview of Appraisal

Appraisal is a procedure whereby either insurers or the insureds can after disagreement invoke appraisal and set the "amount of loss" for a covered claim. Each appoints its appraiser. The appraisers agree on an umpire, or petition the Court to appoint an umpire.[4] Appraisal is concluded by two of the three joining in an award setting the "amount of loss". The award is binding as long as the award is free from "fraud, duress, or other impeaching circumstances" and is covered by the policy.[5] Appraisal is available for first party property damage claims either directly through the policy[6] or through incorporation of the fire insurance statutory provisions.[7]

Appraisal: The Way it Was

During the recent resurgence of appraisal, it became a favored procedure because it was quick, effective, and inexpensive. At an early stage of claim adjustment, vague disagreement over the claim was all that was required to invoke appraisal. Insurers often failed to respond promptly or completely to appraisal. Because the courts viewed appraisal favorably and afforded it the status of quasi-arbitration, insurers did not fare well in litigation over appraisal.[8]

Insurers could not stop or delay appraisal and could not avoid appraisal awards once entered.[9] Courts set aside appraisal awards only where fraud, duress, or other impeaching circumstances existed. Otherwise, courts deferred to appraisal awards and afforded finality to awards setting the amount of loss much like arbitration.[10] Causation was viewed as a neces-

sary part of appraisal of a claim for which there was some damage caused by a covered peril.

Insurers begrudgingly learned from their mistakes. They began to participate promptly and fully in appraisal. Insurers also continued to litigate issues to redefine and limit appraisal. These efforts proved successful and unfortunately removed much of the efficacy of appraisal.[11]

Hailey v. Auto-Owners (2007)

The insured commercial properties in *Hailey* sustained damage from separate ice, wind, and fire events.[12] Insurer initially made payments on the claims, but insured later contended the payments were insufficient.[13] Insured invoked appraisal, appointed an appraiser, and requested insurer appoint its appraiser. Insured filed a declaratory judgment action. Insurer counterclaimed, contending that insured had prematurely invoked appraisal and had not complied with insured's duties after loss so as to create a requisite disagreement.[14]

In a case of first impression in North Carolina, the Court of Appeals in *Hailey* followed precedent from state and federal courts in Florida and agreed with insurer. It held that an insured cannot invoke appraisal until the insured complies with the "duties in the event of loss" as requested by the insurer[15] and a bilateral (not unilateral) disagreement[16] as to value ensues.[17] The "duties in the event of loss" included a duty to provide the insurer "quantities, costs, and values" of the amount of loss claimed.[18]

Although the appraisal clause did not state any condition precedent to invoking appraisal beyond a "disagreement" of value, and the "duties in event of loss" clause did not state any such condition precedent, the Court determined the intent behind the insurance policy was to require the insured's compliance with its duties after loss before invoking appraisal.[19]

There must be a meaningful exchange of information sufficient for each party to arrive at a conclusion before disagreement can exist. Since the *Hailey* insured did not provide any documentation of insured's claimed amount of loss as the insurer had requested, the Court held the appraisals were premature and reversed.[20]

N.C. Farm Bureau v. Sadler (2011)

Sadler originated as a mold claim for insureds' home.[21] After inspecting, insurer denied the claim based on there being no covered damage. Insured then pointed to a specific windstorm and contended that wind damage to the home had allowed water intrusion, and ultimately mold. After another inspection, insurer found damage to covered property (roof damage and interior damage due to roof damage) and tendered a check for $3,203.03, which insured did not cash.[22] Insured then invoked appraisal, appointed his appraiser, and obtained ex parte appointment of an umpire.[23] Insurer then appointed its appraiser.[24]

Insurer's appraisal report found $31,561.39 of damage as a "result of a combination of wind and water damages, along with mold infestation in the lower section of the home, crawl space and floor system". Insured's appraiser and the umpire thereafter joined in an appraisal award of $162,500.00 for the actual cash value of the mold damage "as the result of wind, occurring on May 6, 2005".[25] Insured demanded payment of $150,500 (policy limit). Insurer instead tendered $31,561.39, which insured also did not cash.[26]

Insurer filed a declaratory judgment action.[27] Insurer asserted the award failed to itemize the damages which prevented insurer from determining which items were covered and which were excluded or limited. Insured counterclaimed, asserting breach of contract, UCP, and UDAP for refusal to pay the appraisal award.[28] Insured moved for partial summary judgment on his breach of contract claim only. The Trial Court granted insured's motion. The Court of Appeals unanimously affirmed.[29] After granting insurer's Petition for Discretionary Review, the Supreme Court unanimously reversed, holding that genuine issues of fact precluded the partial summary judgment.[30]

Citing the policy language, the Court noted: "In no event will an appraisal be used for the purpose of interpreting any policy provision, determining causation or determining whether any item or loss is covered under this policy. If there is an appraisal, we will still retain the right to deny the claim."[31]

The Court found that the following genuine issues of material fact existed despite the award: (1) which damages were directly caused by wind and thus covered under the policy, and (2) which parts of the wind-related damages, if any, were directly caused by mold growth and thus limited to a fungi coverage cap under the policy.[32] The Court remanded, instructing that the finder of fact determine if, and how much, of the appraised damage is caused by a covered cause under the policy before all, or part, of the appraisal award is enforced.[33]

Sadler does not address the reality that causation is to some extent an inextricable part of appraisal. The Texas Supreme Court artfully explained how appraisers necessarily have to consider causation:

> Indeed, appraisers must always consider causation, at least as an initial matter. An appraisal is for damages caused by a specific occurrence, not every repair a home might need. When asked to assess hail damage, appraisers look only at damage caused by hail; they do not consider leaky faucets or remodeling the kitchen. When asked to assess damage from a fender-bender, they include dents caused by the collision but not by something else. Any appraisal necessarily includes some causation element, because setting the "amount of loss" requires appraisers to decide be-

tween damages for which coverage is claimed from damages caused by everything else.[34]

Sadler appears to prevent delegation of any causation determination to the appraisal panel. *Sadler* allows the insurer to disagree as to the cause of any portion of the damage, and further to litigate the extent to which any limitation or exclusion would apply to a determination of coverage for such damage.

Appraisal: The Way It Is

Per *Hailey*, and before appraisal can be invoked, insureds must now comply with post-loss policy duties as demanded by the insurer to reach a bilateral disagreement after the exchange of meaningful information.

Per *Sadler*, an appraisal award cannot preempt the insurer's right to a jury trial to resolve factual questions about causation and coverage. Except where there is no disagreement about the link between the peril and the damage and coverage for the resulting damage (e.g., a fire loss), causation and coverage becomes an insurer trump card that prevents a final and binding resolution.

Insureds can no longer invoke appraisal early, avoid causation battles, reduce expenses by handling issues in a more informal appraisal rather than through experts, and achieve a binding award that can be enforced under the threat of treble damages. Why then is appraisal not dead?

Claims Handling Good Faith – Honesty in Fact

Although Chapter 1D limits the utility of bad faith for punitive damage claims, bad faith refusal to adjust and settle claims[35] arguably remains the foundation upon which UCP claims are built. Insurers must see what is there to be seen, evaluate it promptly and in good faith (honesty in fact), and pay when liability is reasonably clear. Appraisal is no longer a way to preempt the claims process and obtain a good result for insureds quickly and inexpensively. However, paradoxically, one can and should use the holdings of *Hailey* and *Sadler* which crippled appraisal to breathe new life into not just appraisal, but the entire claim adjustment.

Knowing that *Hailey* and *Sadler* require a meaningful exchange of information before appraisal is ripe, which insurers will squeeze out of insured by forcing compliance with "duties after loss", don't wait for insurers to ask, seek, or obtain. From the outset, do not permit insurers to control the evaluation. Control it by preparing — at warp speed — a detailed evaluation of the damage and its correlation to the coverage under the policy. You must break down the loss into painful detail, backed by experts as necessary to provide competent opinions (and testimony if also necessary) as to structural damages or any other specific mechanism of damage that proves causation. You can no longer simply have a general contractor provide a generic evaluation of the total cost of repair.

Once you have your detailed evaluation and itemization of the loss, including the cause of the loss paired with the perils covered under the policy, the policy limitations and exclusions you want to avoid if possible, and the itemized amount it will take in the specific market to pay for each item of damage, you are ready to turn the tables on the insurer. You cannot make the insurer provide a similar detailed response, unless you have first done so.

> We must use *Hailey* and *Sadler* to force insurers to address damages and causation with requisite detail.

Under *Hailey* and *Sadler*, you ask that the insurer respond to each itemized element of damage so that the insured can specifically identify the nature and extent of disagreement. The message should be clear. Insured wants to resolve the entire claim, but if that cannot be accomplished, the insured wants to identify as specifically as possible each item of damage for which there is disagreement either as to its cause or coverage under the policy, or as to the amount necessary to repair that specific item.

This is the pressure point. Although insurers won the right to more specificity to define the "disagreement" and preserved their right to litigate causation so they can say some or all of a claim are not covered, in reality insurers do not want to get specific. They prefer to allege generally and hide behind the position asserted without having to support the ingredients of such position. Don't let them.

If the insurer provides matching specificity, there may be specific items of damage about which there is no disagreement. The more specific the insured's estimate is, the better chance there is for agreement on more items. In this event, the insurer is obligated to pay the undisputed portion of the claim.[36]

If the insurer agrees as to causation and coverage but disagrees as to cost of repair, you could then demand appraisal to set the "amount of loss" on those items alone.

If the insurer balks at providing itemized responses that match your estimate, give thanks. UCP is now in play. Continue to prod insurer to engage in the requested "meaningful exchange of information" so that the parties can in good faith separate the disputed from the undisputed and understand the insurer's basis for the dispute it contends exists as to each item.

The whole tenor of *Hailey* and *Sadler* is that the insurer is entitled to fairly evaluate and apply its policy coverage, which it can do only if it secures the insured's full participation in post-loss duties to provide "meaningful" information that is sufficiently itemized to permit proper application of coverage. Well, that shoe fits the other foot as well. The insured is entitled to know precisely how the insurer disagrees with the insured's analysis and repair estimates so that the insurer pays the undisputed amount of the claim and the extent of the "disagreement" is whittled down to those facts about which there is a good faith disagreement.

Hailey and *Sadler* do not absolve insurers from their failure to adjust claims in good faith through which they effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. Insurers violating these duties engage in a *per se* unfair claims practice and unfair trade practice.[37]

Interestingly, appraisal previously found its utility in avoiding the time and expense of itemization and detail. Now by aggressively itemizing and detailing an insured's loss, one can "turn the table" and use appraisal proactively to expose and exploit an insurer's bad faith in avoiding the process. ◆

1. *See, e.g., Pioneer Mfg. Co. v. Phoenix Assurance Co.*, 106 N.C. 28 (N.C. 1890).

2. Statements made about appraisal not cited to legal authority are based on the co-author's (L. Lamar Armstrong, Jr.'s) substantial personal involvement with appraisal from the early 1990's through the present, including being counsel of record in the Hailey and Sadler cases cited herein which he regrets have eliminated much of the utility of appraisal.

3. *See* N.C. Gen. Stat. § 58-63-15(11) (UCP Statute). As a rhetorical thought, is "bad faith" even relevant because punitive damages are now permitted only as provided by Chapter 1D? Also, while it is clear that unfair and deceptive acts and practices in claims adjusting may involve conduct beyond Chapter 58 unfair claims settlement practices (*see Country Club of Johnston County, Inc. v. United States Fid. & Guar. Co.*, 150 N.C. App. 231, 245 (N.C. Ct. App. 2002)), it is most productive to use unfair claims settlement practices as defined by Chapter 58 as the checklist for strategizing your attack on insurers claims adjusting. Therefore, reference in this article will be limited to unfair claims settlement practices or UCP.

4. N.C. Gen. Stat. § 58-44-35.

5. *Harleysville Mut. Ins. Co. v. Narron*, 155 N.C. App. 362 (N.C. Ct. App. 2002).

6. *See, e.g.*, ISO 2010 HO-3 policy form, HO 00 03 05 11, p. 15.

7. N.C. Gen. Stat. § 58-44-16.

8. *Robinson v. North Carolina Farm Bureau Ins. Co.*, 86 N.C. App. 44 (N.C. Ct. App. 1987); *Bentley v. North Carolina Ins. Guaranty Ass'n*, 107 N.C. App. 1 (N.C. Ct. App. 1992); N.C. Farm Bureau Mut. Ins. Co. v. Harrell, 148 N.C. App. 183 (N.C. Ct. App. 2001); *Harleysville Mut. Ins. Co. v. Narron*, 155 N.C. App. 362 (N.C. Ct. App. 2002).

9. *Enzor v. North Carolina Farm Bureau Mut. Ins. Co.*, 123 N.C. App. 544, 546 (N.C. Ct. App. 1996); *N.C. Farm Bureau Mut. Ins. Co. v. Harrell*, 148 N.C. App. 183 (N.C. Ct. App. 2001).

10. *See, e.g., N.C. Farm Bureau v. Harrell*, 148 N.C. App. 183 (N.C. Ct. App. 2001).

11. *See Hailey v. Auto-Owners Ins. Co.*, 181 N.C. App. 677; 640 S.E.2d 849 (2007); *N.C. Farm Bureau Mut. Ins. Co. v. Sadler*, 365 N.C. 178; 711 S.E.2d 114 (2011).

12. *Hailey*, 181 N.C. App. at 678.

13. *Id.* at 678.

14. *Id.*

15. The policies in *Hailey* (like typical property-casualty policies) provide certain enumerated duties of the insured post loss (mitigate, allow inspection, provide documentation, etc.).

16. The appraisal clauses in the *Hailey* policies (like typical property-casualty policies) provide for appraisal only in the event of "disagreement" as to value.

17. *Id.* at 686-87.

18. *Id.* at 679.

19. *Id.* at 687.

20. *Id.* The insured did provide a loss estimate for one of its damaged properties, which the Court rejected because the insured did not provide any "support" for that estimate.

21. *Sadler*, 365 N.C. at 179.

22. *Id.*

23. *Id.* at 179, 180.

24. *Id.* at 180.

25. *Id.*

26. *Id.* at 180, 181.

27. *Id.* at 181.

28. *Id.*

29. *Id.*

30. *Id.* at 184.

31. *Id.* at 181.

32. *Id.* at 183. As explained in more detail in the Court of Appeals opinion, insurer argued that genuine issues of material fact remained as to whether insured's damages resulted from wind or causes specifically excluded, such as long-term water leaks and lack of flashing around the windows, settlement of the foundation, and expansion and contraction of framing and finishes due to seasonal moisture changes. *N.C. Farm Bureau v. Sadler*, 204 N.C. App. 145, 152; 693 S.E.2d 266, 271 (N.C. Ct. App. 2010).

33. *Id.* at 184.

34. *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (TX 2009).

35. *Dailey v. Integon General Ins. Corp.*, 75 N.C. App. 387; 331 S.E.2d 148 (1985). Bad faith means "not based on honest disagreement or innocent mistake". *Id.* at 396.

36. *See*, N.C. Gen. Stat. § 58-63-15(11)(various subparts provide ample support for contending that insurers must pay what is clearly covered under the policy and about which cost of repair is undisputed. *See also*, *Page v. Lexington Ins. Co.*, 177 N.C. App. 246, 250 (N.C. Ct. App. 2006)).

37. *Gray v. North Carolina Ins. Underwriting Ass'n*, 352 N.C. 61, 529 S.E.2d 676 (2000).