Case Alert

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Colorado Supreme Court Decision Could Tarnish Appraisal Process for Policyholders

On June 24, 2019, the Colorado Supreme Court ruled that the plain language of appraisal provisions in insurance policies, requiring "impartial appraisers," direct appraisers to be "unbiased, disinterested, and unswayed by personal interest," regardless of who hires them, and prohibits the party-appointed appraisers from acting as advocates.

A common and attractive alternative dispute resolution option, the appraisal process usually entails the policyholder and insurer each hiring their own appraiser, who estimates how much the claim is worth. These appraisers also select a third-party umpire, and if they cannot agree upon one, a court appoints one. The umpire analyzes the conflicting estimates and presents a number to resolve the dispute. If two of the three parties agree with the outcome, the number becomes binding.

Owners Ins. Co. v. Dakota Station II Condo. Ass'n, Inc.[1] began when Dakota Station II Condominium Association Inc. ("Dakota") and its insurer, Owners Insurance Company ("Owners") could not agree on how to value two claims arising out of weather damage. To settle the differences and come to a resolution, Dakota invoked the appraisal provision in the insurance policy instructing each party to select its own "competent and impartial appraiser." Ultimately, a court-appointed umpire considered six cost categories in dispute and adopted four of Owners' estimates and two of Dakota's.

Owners filed a petition to vacate the award, alleging that Dakota's appraiser "acted improperly by entering into a contract … that capped her fees at five percent of the insurance award (allegedly giving her a financial interest in the outcome)." Under this fee arrangement it was possible that the appraiser would collect more fees for a higher award. Owners argued that the appraiser's potential financial interest meant that the appraiser was not "impartial" as required by the policy.

After two lower courts held in favor of the insured, the Colorado Supreme Court granted certiorari and considered two issues: (A) the meaning of the language "impartial" in the appraisal provision, and (B) whether the fee arrangement meant that Dakota's appraiser was not impartial as a matter of law.

The Court affirmed the lower court's holdings in part, holding that appraisers were not necessarily held to the same strict standards of impartiality as arbitrators. On the other issues, the Court overturned the lower court. The Court held that the appraisal provision is not ambiguous, and that the plain meaning of "impartial" is "[n]ot favoring one side more than another; unbiased and disinterested; unswayed by personal interest." In comparing this with the plain meaning of "advocate" – "[s]omeone who assists, defends, pleads, or prosecutes for another" – the court concluded that an appraiser cannot simultaneously advocate for a party and be impartial.

The Court relied on the fact that there is nothing in the provision suggesting that an appraiser would put forth values on behalf of a party that hired it. "[W]e can't endorse a reading of the impartiality requirement that suggests one can simultaneously be an 'advocate' for one of the parties and be 'impartial.'"

The Court also concluded that in this case, the contingent-cap fee arrangement did not render the appraiser biased as a matter of law. The fees did not reach a level that would have been capped, even under Owner's appraiser's valuation, and thus the contingent-cap did not affect what the appraiser was paid. The appraiser did not "believe the cap was in effect and there is seemingly no relationship between the fees billed by the appraiser and the estimates she put forth, we can't say that hypothetical incentives rendered her partial."

Several judges dissented from the majority opinion, warning that the holding further "tips the scale in favor of the insurance industry," widening the imbalance of power in this area.

The holding may be impractical, requiring humans to ignore their natural instincts, because "when an appraiser advocates for her own work and final valuation, she essentially advocates for one party, and it's human nature to expect (and want) an appraiser to advocate for her own work and final valuation." It seems unlikely that each party would select and compensate its own appraiser and expect that appraiser to not advocate for or favor its side. After all, the umpire is supposed to fulfill the unbiased third-party role in the appraisal process.

Colorado's holding should put both insurers and policyholders on notice to review the language of appraisal provisions commonly found in first party policies, including homeowners, commercial property, and builders risk insurance. Parties should consider whether this is the arrangement they want and whether to negotiate for a process that expressly allows for appraisers to advocate on their behalf to the umpire. Otherwise, they run the risk that a favorable award can be vacated based on an after-the-fact showing of partiality or bias.

In addition to reviewing appraisal provisions, parties should carefully consider the appraiser selection process and vet potential appraisers before the appraisal process begins.

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1. No. 17SC583, 2019 WL 2571645 (Colo. June 24, 2019).