

A New Texas Two-Step? Appraisal in Texas After *State Farm Lloyds v. Johnson*

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I. Introduction

The Texas Supreme Court's decision in *State Farm Lloyds v. Johnson*² is widely viewed as disrupting the *status quo*, unsettling the expectations of both carriers and policyholders as to what kinds of disputes are properly appraisable. *Johnson* reinforces the traditional view that the proper scope of appraisal is limited to "damages", not "liability", but muddies the waters in terms of distinguishing one from the other. It also appears to invite expanded collateral attacks on appraisal awards. And it arguably does so in *dicta*, since much of the Court's discussion is immaterial to its ultimate holding.

Nevertheless, the opinion raises some interesting and largely unexamined practical questions concerning the determination of the "amount of loss" versus the "extent of damage" in appraisal. Part of the confusion that the case engenders may stem from the particular issue presented – the apportionment of hail damage from preexisting conditions. But while the opinion has created uncertainty and unquestionably expands the perceived scope of appraisal in Texas, it may not represent as significant a departure from prior law as the reactions to it might suggest. *Johnson* should not be read to permit the determination of true causation, coverage or liability issues in appraisal, but it may introduce a new Texas "two-step".

II. Distinguishing Appraisal from Arbitration

Public policy favors alleviating the burden on courts through alternative dispute resolution procedures, including arbitration and appraisal. Both approaches are a means of accomplishing this goal while ostensibly providing the parties greater flexibility, efficiency, and privacy.³ But despite the shared purpose, insurance appraisals are distinct from arbitrations.⁴ Specifically, an insurance appraisal, which is a means of

¹ The views and opinions expressed in this paper are solely those of the authors and do not reflect the views or opinions of Zelle Hofmann Voelbel & Mason LLP or any of its clients.

² *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009).

³ See *Trudy's Tex. Star, Inc. v. Weingarten Realty Investors*, No. 03-03-00538-CV, 2004 Tex. App. LEXIS 7161, at *11 (Tex. App.—Austin Aug. 12, 2004, pet. denied).

⁴ See *In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193 (Tex. 2002); *Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1061 (5th Cir. 1990).

determining the *value* of a loss, is not equivalent to arbitration.⁵ The Texas Supreme Court "... distinguished between appraisal and arbitration clauses over a hundred years ago."⁶ This distinction has been recognized by the United States Court of Appeals for the Fifth Circuit⁷ and by Texas courts.⁸ As explained by the Fifth Circuit, "[w]hile both procedures aim to submit a dispute to a third party for speedy and efficient resolution without recourse to the courts, there are significant differences between them."⁹

Arbitration, for example, can be used to resolve an entire controversy, including factual and legal disputes.¹⁰ The issues to be determined are submitted to a single arbitrator or to an arbitration panel. Although typically not bound by the rules of evidence, arbitration is a formal and quasi-judicial process complete with hearings, notices, and testimony, and may be governed by AAA (or similar) rules and/or protocols agreed to by the parties.¹¹

Appraisal, on the other hand, is not intended to address issues of liability, but only to determine the "amount of loss" when an insurer acknowledges coverage but disagrees with its insured as to the value of a loss.¹² Appraisal is typically an informal process governed by the appraisal provision in the insurance contract, the preferences of the appraisers, and any protocols entered into by the parties. A typical appraisal clause requires each side to select an appraiser, and for the two appraisers to attempt to reach agreement as to the "amount of loss". If the two appraisers cannot agree on the amount of loss, then the parties must select an umpire, who may be appointed by a court if the parties cannot agree.

⁵ *Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1062 (5th Cir. 1990) (citing *Standard Fire Ins. Co. v. Fraiman*, 514 S.W.2d 343, 344 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ); *Huntington Corp. v. Inwood Constr. Co.*, 348 S.W.2d 442, 444 (Tex. Civ. App.—Dallas 1961, writ ref'd n.r.e.); 7 TEX.JUR.3d Arbitration and Award 1 (1980); 46 TEX.JUR.3d Insurance Contracts and Coverage 466 (1986)); *In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193 (Tex. 2002).

⁶ *In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193, 195 (Tex. 2002) (discussing *Scottish Union & Nat'l Ins. Co. v. Clancy*, 8 S.W. 630, 631 (Tex. 1888)).

⁷ See *Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1061 (5th Cir. 1990).

⁸ See, e.g., *Standard Fire Ins. Co. v. Fraiman*, 514 S.W.2d 343, 344 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ); *Huntington Corp. v. Inwood Constr. Co.*, 348 S.W.2d 442, 444 (Tex. Civ. App.—Dallas 1961, writ ref'd n.r.e.).

⁹ *Teachworth*, 898 F.2d at 1062.

¹⁰ *Scottish Union & Nat'l Ins. Co. v. Clancy*, 8 S.W. 630, 631 (Tex. 1888) (concluding that arbitration determines the rights and liabilities of the parties, while appraisal merely "binds the parties to have the extent or amount of the loss determined in a particular way."); *Teachworth*, 898 F.2d at 1061-62.

¹¹ *Teachworth*, 898 F.2d at 1062.

¹² See *Wells v. Am. States Preferred Ins. Co.*, 919 S.W.2d 679, 685 (Tex. App.—Dallas 1996, writ denied) (explaining the difference between arbitration and appraisal, noting that appraisers do not have the power to decide the cause of loss but only the value of the loss, "the function of the appraisers is to determine the amount of damage resulting to the property submitted for their consideration. It is certainly not their function to resolve questions of coverage and interpret provisions of the policy.").

Unlike arbitration, in which a single arbitrator or an arbitration panel makes an independent and impartial determination, the appraisal process requires each appraiser to independently assess the loss and attempt to reach agreement. Only the disputes that cannot be resolved by the appraisers are presented to the umpire.¹³ The umpire, in agreement with at least one of the appraisers, must then determine the “amount of loss”.

III. Before *State Farm Lloyds v. Johnson*

Historically, appraisal clauses have been interpreted fairly consistently under Texas law. Policyholders and insurers alike have had an established body of case law to rely upon, guiding them as to the authority of appraisers and umpires, their qualifications, the binding nature of appraisal, and when an appraisal award can be challenged.

It is understood, for example, that the appraisal process is to be carried out by two competent and *disinterested* appraisers, without any financial interest in the award.¹⁴ While in practice it may not always be the case, each party’s appraiser is, at least in theory, not supposed to be a partisan.¹⁵ It is also well-established that, while appraisal is usually invoked prior to suit (and courts have found that it is in fact a condition precedent to suit),¹⁶ if suit is already underway it does not have to be abated if one of the parties subsequently seeks appraisal.¹⁷ Further, Texas courts have determined that both the insurer and the insured have the right to demand appraisal under standard policy language.¹⁸ Where a demand is properly made, a court’s refusal

¹³ See also George J. Couch, *et al.*, Couch on Insurance § 50:5 (2d Ed. 1982) (“An agreement for arbitration, as that term is now generally used, encompasses the disposition of the entire controversy between the parties upon which award a judgment may be entered, whereas an agreement for an appraisal extends merely to the resolution of the specific issues of cash value and the amount of loss, all other issues being reserved for settlement by negotiation, or litigated in an ordinary action upon the policy. For example, it has been said that a clause in a fire policy providing for simple appraisal of values, so as to determine the amount of loss, is distinct from an arbitration clause, whereby the parties seek to substitute tribunals other than courts to determine an entire controversy.”).

¹⁴ See *Holt v. State Farm Lloyds*, CA 3:98-CV-1076-R, 1999 U.S. Dist. LEXIS 6257, *10-13 (N.D. Tex. Apr. 21, 1999); *Gen. Star Indem. Co. v. Spring Creek Village Apt. Phase V, Inc.*, 152 S.W.3d 733, 737 (Tex. App.—Houston [14th Dist.] 2004, no pet.); *Pa. Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm’n App. 1931, no writ).

¹⁵ See *Pa. Fire Ins. Co. v. W.T. Waggoner Estate*, 39 S.W.2d 593, 594-595 (Tex. Comm’n App. 1931, no writ) (citing *Del. Underwriters v. Brock*, 211 S.W.2d 779, 780 (Tex. 1919)).

¹⁶ See *Scottish Union & Nat’l Ins. Co. v. Clancy*, 8 S.W. 630, 631-32 (Tex. 1888) (holding appraisal was condition precedent to litigation); *Am. Cent. Ins. Co. v. Terry*, 26 S.W.2d 162, 166 (Tex. Comm’n App. 1930, holding approved); *Vanguard Underwriters Ins. Co. v. Smith*, 999 S.W.2d 448, 450 (Tex. App.—Amarillo 1999, no pet.); *Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist.*, 877 S.W.2d 872, 878 (Tex. App.—San Antonio 1994, no writ).

¹⁷ *In re Allstate Ins. Co.*, 85 S.W.3d at 195.

¹⁸ *Standard Fire Ins. Co. v. Fraiman*, 514 S.W.2d 343, 346 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ).

to enforce the appraisal process is an abuse of discretion, since it would prevent the party demanding appraisal from obtaining independent valuations.¹⁹

A number of Texas courts have held that the right to invoke appraisal can be waived. The waiver inquiry looks to the party's knowledge at the time, and whether they expressly or impliedly acted in a manner that showed an intent to relinquish their right to appraisal.²⁰ Texas courts have found waiver where appraisal was not sought in a timely fashion or not demanded in compliance with the policy.²¹ Waiver has also been found where an insurer demanded appraisal but subsequently failed to participate,²² accepted a proof of loss or retained one for an unreasonable amount of time before demanding appraisal,²³ or where an insurer denied the claim altogether.²⁴

Moreover, it is well accepted that once an amount of loss is determined by the appraisal process, it is binding on the parties if the appraisal was properly sought and carried out.²⁵ Courts have repeatedly stated that "[e]very reasonable presumption will be indulged to sustain an appraisal award."²⁶ Appraisal awards may be challenged, however: (1) when the award is made without authority; (2) when the award results from fraud, accident, or mistake; and (3) when the award was not made in substantial compliance with the policy.²⁷

¹⁹ *In re Allstate Ins. Co.*, 85 S.W.3d at 195.

²⁰ See *Am. Century Ins. Co v. Terry*, 26 S.W.2d 162, 166 (Tex. 1930) (stating that waiver can be established by: "(a) Parol waiver; (b) refusal to arbitrate; (c) denial of liability; (d) failure to demand arbitration or appraisal; (e) acts inconsistent with intention to arbitrate; (f) appointment of a prejudiced appraiser; (g) improper conduct during appraisement."); *Scottish Union & Nat'l Ins. Co. v. Clancy*, 83 Tex. 113, 18 S.W. 439, 441 (1892) (holding that "the acts relied on as constituting a waiver should be such as are reasonably calculated to make the assured believe that a compliance on his part with the stipulations providing the mode of proof of loss and regulating the appraisement of the damage done is not desired, and that it would be of no effect if observed by him.").

²¹ *Serv. Co. v. Brodie*, 337 S.W.2d 414, 416-17 (Tex. Civ. App.—Fort Worth 1960, writ ref'd n.r.e.).

²² *N. Assurance Co. v. Samuels*, 33 S.W. 239, 242 (Tex. Civ. App.—San Antonio 1895, no writ) (finding that the evidence conclusively showed that the demand for appraisal was abandoned by the insurer).

²³ *Springfield Fire & Marine Ins. Co. v. Cannon*, 46 S.W. 375 (Tex. Civ. App. 1898, no writ); *Am. Fire Ins. Co. v. Stuart*, 38 S.W. 395, 396 (Tex. Civ. App. 1896, no writ).

²⁴ *In re Acadia Ins. Co.*, 279 S.W.3d 777, 780 (Tex. App.—Amarillo 2007, orig. proceeding) (citing *Am. Cent. Ins. Co. v. Terry*, 26 S.W.2d 162, 166 (Tex. Comm. App. 1930, holding approved)).

²⁵ *Scottish Union & Nat'l Ins. Co. v. Clancy*, 8 S.W. 630, 631 (Tex. 1888) ; *Franco v. Slavonic Mut. Fire Ins. Ass'n*, 154 S.W.3d 777, 786 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (citing *Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist.*, 877 S.W.2d 872, 875 (Tex. App.—San Antonio 1994, no writ)).

²⁶ *Franco v. Slavonic Mut. Fire Ins. Ass'n*, 154 S.W.3d 777, 786 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (citing *Providence Lloyds Ins. Co. v. Crystal City Indep. Sch. Dist.*, 877 S.W.2d 872, 875 (Tex. App.—San Antonio 1994, no writ) (citing *Cont'l Ins. Co. v. Guerson*, 93 S.W.2d 591, 594 (Tex. Civ. App.—San Antonio 1936, writ dismissed))).

²⁷ *Franco*, 154 S.W.3d at 786; *Wells*, 919 S.W.2d at 683-85; *Providence Lloyds v. Crystal City Indep. School Dist.*, 877 S.W. 872, 875 (Tex. App.—San Antonio 1994, no writ).

It also generally understood that appraisal is to be used to determine the “amount of loss” only.²⁸ Most courts have interpreted this to mean that appraisal is not appropriate to determine questions of causation, coverage, or liability.²⁹ The *Johnson* Court stated that “Texas courts have split on th[e] question” of whether appraisers can decide causation issues, but it cited just one Texas case to support the appraisability of causation questions.³⁰ It is this question – the proper scope of appraisal – together with the question of when challenges to appraisal should be addressed by the courts, that has left so many practitioners scratching their heads after *Johnson*.

IV. *State Farm Lloyds v. Johnson*

In *Johnson*, a homeowner filed a claim with State Farm Lloyds for the cost of roof repairs after a hail storm. State Farm’s inspector concluded that hail had only damaged the ridgeline of the roof. The discrepancy in repair costs was significant. The insured’s claim amounted to more than \$13,000, but the carrier found only \$499.50 in covered repair costs (an amount less than the policy deductible). The insured demanded appraisal under the following provision:

Appraisal. If you and we fail to agree on the amount of loss, either one can demand that the amount of the loss be set by appraisal. If either makes a written demand for appraisal, each shall select a competent, disinterested appraiser. Each shall notify the other of the appraiser's identity within 20 days of receipt of the written demand. The two appraisers shall then select a competent, impartial umpire.... The appraisers shall then set the amount of the loss. If the appraisers submit a written report of an agreement to us, the amount agreed upon shall be the amount of the loss. If the appraisers fail to agree within a reasonable time, they shall submit their differences to the umpire. Written agreement signed by any two of these three shall set the amount of the loss.

State Farm refused to appraise. In State Farm’s view, the disagreement was one of *causation*, which it believed to be outside the scope of appraisal, not the “amount of loss”. The insured responded by filing suit seeking a declaratory judgment compelling appraisal. The trial court, on cross-motions for summary judgment, ruled for State Farm. The Dallas Court of Appeals reversed. Ultimately, the Texas Supreme Court affirmed the Court of Appeals’ order compelling State Farm to participate in appraisal, but noted

²⁸ See *Wells*, 919 S.W.2d at 683-84.

²⁹ *Wells*, 919 S.W.2d at 684. See also *Salinas v. State Farm Lloyds*, 267 Fed. Appx. 381, 386 (5th Cir. 2008); *Holt v. State Farm Lloyds*, No. CA 3:98-CV-1076-R, 1999 U.S. Dist. LEXIS 6257, 1999 WL 261923, at *3 (N.D. Tex. April 21, 1999); *Germania Farm Mut. Ins. Ass’n v. William*, No. 11-00-00393-CV, 2002 Tex. App. LEXIS 9376, 2002 WL 32341841, at *3-4 (Tex. App.—Eastland May 23, 2002, no pet.).

³⁰ *Johnson*, 290 S.W.3d at 890-891 n.24 (citing *Lundstrom v. United Servs. Auto Ass’n-CIC*, 192 S.W.3d 78, 89 (Tex. App.—Houston [14th Dist.] 2006, pet. denied)).

that “we do not decide today whether the appraisal conducted on remand will necessarily be binding.”³¹

The opinion begins with a brief history of appraisal clauses, generally confirming their validity. The Court then briefly addresses the appropriateness of appraising “damage questions”. Contrasting “damage questions” with “liability questions”, it stated that “...limiting appraisal to damages and not liability is surely still correct.”³² Thus, the Court was unequivocal in its statement that “the scope of appraisal is [still] damages, not liability.”³³

The discussion then moves to the appropriateness of appraising *causation*, the basis on which State Farm refused appraisal. As an initial matter, the Court concluded that the dispute before it was not *about* causation. Specifically, it found that, notwithstanding the denial letters in evidence, “nothing in the summary judgment record” established that the roof was damaged by anything other than hail. Nor, the Court concluded, was it clear from the record that the dispute was solely about “...how much of the roof was damaged rather than how much needs to be replaced.”³⁴ The Court stated that “the cost of replacing shingles (or anything else) is a function of both *price* and *number*” and that appraisers must factor in both to decide the amount of loss.³⁵ The Court further stated that “to the extent the parties disagree which shingles needed replacing, that dispute would fall within the scope of appraisal.”³⁶

This conclusion alone would have been sufficient to affirm the Court of Appeals. The Court nevertheless proceeded to discuss whether, even if a dispute “involves” causation, it presents a question of liability or damages. It is this discussion which is the most interesting – and the most confusing – part of the opinion.

The Court’s fundamental thesis is that disputes which “involve” causation may nevertheless be appraisable, a notion with which most attorneys familiar with the case law likely would have disagreed. Citing the well-known Texas cases of *Wells v. American States Preferred Insurance Co.*³⁷ and *Lundstrom v. United States Automobile Association*,³⁸ the Court attempted to distinguish *Wells*, in which appraisers

³¹ *Johnson*, 290 S.W.3d at 896.

³² *Id.* at 889-90.

³³ *Id.* at 890.

³⁴ *Id.* at 891.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Wells*, 919 S.W.2d 679.

³⁸ *Lundstrom v. United Servs. Auto. Ass’n*, 192 S.W.3d 78, 88 (Tex. App.—Houston [14th Dist.] 2006, pet. denied).

impermissibly distinguished between covered and excluded causes of damage, from the permissible appraisal in *Lundstrom*.³⁹

In *Wells*, the insured's home sustained damage from foundation movement and the insurer demanded appraisal. The insured contended that the foundation movement was due to a plumbing leak, a covered cause of loss. Both appraisers and the umpire agreed on the amount of damage to the structure. But the carrier's appraiser and the umpire determined that none of the damage was caused by a plumbing leak. In reviewing the appraisal award, the Dallas Court of Appeals concluded that the appraisers had exceeded their authority by making a causation determination that should have been left for the court.⁴⁰ The *Johnson* Court ostensibly agreed with this result, noting that "[a]ppraisers can decide the cost of repairs in this context, but if they can also decide causation there would be no liability questions left for the courts."⁴¹

The *Johnson* Court then contrasted *Wells* with *Lundstrom*. In *Lundstrom*, the insured's home was damaged by water intrusion from a leaking roof. The insured also claimed mold damage and ensuing loss. The Lundstroms' insurer, USAA, agreed that damage from the initial water intrusion was covered and requested that the appraisers determine the amount of that loss only. The mold damage and ensuing loss claims presented coverage issues and were specifically excepted from the appraisal. The appraisal panel entered an award for damages from the "initial wetting" only.

The Lundstroms challenged the award on appeal, contending that the appraisers lacked authority because coverage and causation were disputed. The 14th Court of Appeals affirmed the award concluding that, unlike *Wells*, there were no coverage issues before the umpire and appraiser and the panel did not partition the loss among various causes. The *Johnson* Court cited *Lundstrom* as "[r]ejecting the argument that appraisal is barred 'whenever causation factors into the award'".⁴² This would seem to be a dubious reading of *Lundstrom*, but the Court nevertheless proceeded to use it as a basis for its conclusion that separating damage resulting from a covered cause and a pre-existing condition was also appropriate for appraisal.⁴³ The Court also cites various Texas Pattern Jury Charges on liability and damages as support for its argument, another reference that seems misplaced since appraisers lack the broad mandate of a juror.⁴⁴

However questionable the Court's reliance on these authorities may be, the Court makes an interesting practical point about appraisal that better supports its view. Specifically, the Court notes that appraisers "must always consider causation, at least

³⁹ *Johnson*, 290 S.W.3d at 892.

⁴⁰ *Wells*, 919 S.W.2d at 685.

⁴¹ *Johnson*, 290 S.W.3d at 892.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

as an initial matter” because “appraisal is for damages caused by a specific occurrence, not every repair a home might need.”⁴⁵ The Court goes on to observe that, for example, “[w]hen asked to assess damage from a fender-bender, they include dents caused by the collision but not by something else.”⁴⁶ Thus, the Court suggests that appraisers always implicitly consider causation to some degree in making their determinations, a point that cannot reasonably be disputed.

Setting this aside for the moment, the aspect of the *Johnson* opinion having the greatest impact on both policyholders and carriers is the Court’s conclusion that, even if a causation question might exist that exceeds the scope of appraisal, “appraisals should generally go forward without preemptive intervention”.⁴⁷ The Court gives four reasons in support of this conclusion. First, a burden/benefit analysis in which the Court concludes that it would be a “rare case in which appraisal could not be completed with less time and expense than it would take to file motions contesting it.”⁴⁸ Second, the Court opines that appraisals can typically be structured to decide the amount of loss without deciding liability questions.⁴⁹ Third, the Court suggests that the appraisal itself may resolve such disputes.⁵⁰ Fourth, the Court concludes that even if an appraisal award is flawed, it “can be easily remedied by disregarding it later.”⁵¹

The Court’s reasoning is not well-supported, nor does it explain under what circumstances a pre-appraisal hearing may be appropriate, if ever. The Court’s conclusion suggests that even parties with true coverage, causation, or liability issues may have to go through an appraisal proceeding before obtaining a determination of whether appraisal is appropriate. It opens the door to additional collateral attacks on appraisal awards, and it is dismissive of the costs and burdens on parties who may have to “re-appraise”. As a result, parties struggling with these issues have less clarity, and face greater uncertainty and potentially greater expense and delay than they did pre-*Johnson*.

V. How Significant a Change does *Johnson* Represent?

There is much not to like about *Johnson* – but it would be a mistake for parties or courts to read it too broadly. Fundamentally, *Johnson* stands for just two propositions: (1) that separating loss due to a covered event from preexisting damage is initially appraisable, albeit subject to post-appraisal review; and (2) that, at least in the absence of evidence that the damage at issue was caused by “something else”, appraisal should proceed without judicial intervention. Based on the existing case law and the supportive

⁴⁵ *Id.* at 893.

⁴⁶ *Id.*

⁴⁷ *Id.* at 895.

⁴⁸ *Id.* at 894.

⁴⁹ *Id.*

⁵⁰ *Id.* at 894-895.

⁵¹ *Id.* at 895.

statements in *Johnson*, it seems clear that appraisal of an issue of true “causation” – apportioning between excluded faulty workmanship and covered ensuing loss, for example, or apportioning between covered wind damage and excluded flood damage – would exceed an appraiser’s scope of authority. So would an appraisal that attempted to determine issues of coverage or liability under the policy. *Johnson* specifically affirms the principle that appraisal is limited to questions of “damages” not “liability”.

But the Court’s observation that appraisers implicitly consider causation to some degree in determining an “amount of loss” is undeniably true. An appraisal panel determining the scope of damage from a fire in good faith would not, for example, include an award for roof damage repairs if the fire never reached the roof, nor would it include an award for the repair or replacement of wood that was rotted by termites. Appraisers and the umpire must make some assessment of the pre-loss condition of the property. Moreover, if both parties must agree on the exact scope of the covered damage before an appraisal takes place, then all one party would have to do to thwart appraisal is to contend, for example, that sixteen roof shingles were damaged, not fifteen, or vice-versa. This makes little sense and, in practice, has not been the case.

The difficult question, which the *Johnson* Court did not resolve, is at what point do appraisers step over the line into *impermissible* causation determinations? In *Johnson*, the carrier acknowledged that there was some covered damage. But suppose a situation in which the carrier’s view is that *all* of the damage is preexisting. Would that make a difference under *Johnson*? If the parties submit conflicting expert reports on causation, will that provide a basis for pre-appraisal judicial intervention? If a carrier agrees that there is some covered damage to certain items, will the appraisal be limited to only those items? If the appraisers implicitly determine causation issues that are beyond their authority, how will a subsequent court review those determinations? The Court seems to believe that many of the thornier issues will simply work themselves out in an appraisal. The unstated rationale underlying *Johnson* may be one of perceived judicial economy.

In the interim, parties seeking greater certainty and control can attempt to protect themselves through the use of a protocol specifying the scope of the appraisal and what the appraisal panel is being asked to determine (e.g., actual cash value, repair and/or replacement cost). While neither party is obligated to enter into such a protocol, there are reasons why both policyholders and carriers might want to. Defining the scope of an appraisal helps minimize the risk of a collateral attack by either party. And, requesting that the appraisal panel render its award in a specific form provides guidance to the panel and results in greater overall clarity in the appraisal process and award.

VI. Subsequent Interpretations of *Johnson*

Courts outside of Texas have acknowledged that the *Johnson* approach to appraisal may actually increase inefficiencies and costs. The United States District Court for the Southern District of Mississippi, recognizing that “[t]heoretically, appraisal should be self-enforcing or self-governing[.]...” deemed “questionable the comments in

[*State Farm Lloyds v. Johnson*]” that “[a]ppraisals require no attorneys, no lawsuits, no pleadings, no subpoenas, and no hearings. It would be a rare case in which appraisal could not be completed with less time and expense than it would take to file motions contesting it.”⁵² The court commented that its experience did not support such statements, and tended to agree with the Plaintiff’s argument that “ ... the parties will inevitably be before this Court again, disputing some issue of appraisal.”⁵³ This court was also clear in its statement that the scope of appraisal is to be limited to the amount of loss without accounting for *causation*.⁵⁴

But courts applying Texas law have largely followed, not criticized, *Johnson*. The opinion has been relied upon as support for compelling appraisal,⁵⁵ even where causation issues may arise during the process.⁵⁶ In *Sanchez v. Property & Casualty Insurance Company of Hartford*, the court found that the insurer had waived its right to appraisal and denied the insurer’s motion to compel appraisal on that basis.⁵⁷ But the court also acknowledged the insured’s argument that appraisal was inappropriate because the dispute was over coverage.⁵⁸ The *Sanchez* court read *Johnson* as

⁵² *Sunquest Props., Inc. v. Nationwide Prop. & Cas. Co.*, No. 1:08cv687-LTS-RHW, 2009 U.S. Dist. LEXIS 80380, at *3 (S.D. Miss. Aug. 18, 2009). See also *Pearl River County Sch. Dist. v. RSUI Indem. Co.*, No. 1:08CV364HSO-JMR, 2009 U.S. Dist. LEXIS 80374 (S.D. Miss. Aug. 17, 2009) (refusing to following *Johnson* where case was decided under Mississippi law).

⁵³ *Sunquest*, 2009 U.S. Dist. LEXIS 80380, at *3 (internal quotations omitted).

⁵⁴ *Id.* at *5-6.

⁵⁵ See, e.g., *In re Slavonic Mut. Fire Ins. Ass’n*, No. 14-09-01057-CV, 2010 Tex. App. LEXIS 2365, at *21 (Tex. App.—Houston [14th Dist.] Apr. 1, 2010) (declining to find waiver, and citing *Johnson*, 290 S.W.3d at 895 as support for the position that “appraisals should generally go forward without preemptive intervention by the courts”); *Woodward v. Liberty Mut. Ins. Co.*, No. 3:09-CV-0228-G, 2010 U.S. Dist. LEXIS 29250, at *16, *7-8 (N.D. Tex. Mar. 26, 2010) (granting insurer’s motion to compel appraisal, and citing *Johnson*, 290 S.W.3d at 894 to support that an appraisal provision is a condition precedent to bringing suit on the contract). See also *Comty. Bank v. Bancinsure, Inc.*, No. 2:09-CV-125-TJW, 2010 U.S. Dist. LEXIS 26948, at *9, *8 (E.D. Tex. Mar. 22, 2010) (finding a question of fact as to whether the right to appraisal had been waived, but citing *Johnson*, 290 S.W.3d at 894 to support that “[a]n appraisal is typically conducted prior to initiating a lawsuit, and the Texas Supreme Court has stated that it is a condition precedent to suit.”).

⁵⁶ See *In re Slavonic Mut. Fire Ins. Ass’n*, No. 14-09-01057-CV, 2010 Tex. App. LEXIS 2365, at *4 (Tex. App.—Houston [14th Dist.] Apr. 1, 2010) (stating that “[m]ore recently, the supreme court has expressed a strong policy in favor of enforcing appraisal clauses in insurance contracts. *State Farm Lloyds v. Johnson*, 290 S.W.3d at 891-93 (holding that insurer is bound by appraisal clause to have amount of loss determined, even when dispute also involves questions of causation)...”); *Molzan, Inc. v. United Fire & Cas. Co.*, No. H-09-01045, 2009 U.S. Dist. LEXIS 63979 (S.D. Tex. July 23, 2009) (relying on *Johnson* as support for requiring appraisal despite coverage questions).

⁵⁷ *Sanchez v. Prop. & Cas., Ins. Co. of Hartford*, No. H-09-1736, 2010 U.S. Dist. LEXIS 6295, at *17, *26 (S.D. Tex. Jan. 27, 2010).

⁵⁸ *Sanchez*, 2010 U.S. Dist. LEXIS 6295, at *26.

“stat[ing] in no uncertain terms that pre-appraisal litigation about the scope of appraisal is generally not permitted.”⁵⁹

Johnson was followed and extensively discussed by the United States District Court for the Southern District of Texas in *Molzan, Inc. v. United Fire & Casualty Co.*⁶⁰ When the insured’s restaurant, The Ruggles Grill, was damaged by Hurricane Ike in 2008, it was undisputed that the policy at issue covered some of the losses from the damage. But the insured claimed additional damages for both property loss and lost business income. The insured made a written demand for appraisal, which was rejected by its carrier.⁶¹

The insured claimed storm damage to a rusted hood vent in the kitchen, rusted kitchen equipment, stained glass windows, a mural on the ceiling, a painting on the exterior of the building, and a pasta machine, rotisserie, and sound system. It also claimed additional business income losses. Concerning the property damage, the carrier asserted that those losses were excluded by the insured’s failure “to use all reasonable means to save and preserve the property from other damage[,]” or that they were not covered losses to begin with because the damage was not caused by the storm.⁶² Regarding the business income losses, the carrier asserted that the dispute concerned the period of interruption, not the monthly amount of loss. The carrier took the position that appraisal would only be appropriate if there were a dispute over “the worth of damaged property”, “the cost to perform the repairs identified ... as resulting from a covered loss,” or “the monthly [business income loss] amounts.”⁶³

The court disagreed, granting the insured’s motion to compel appraisal based on *Johnson*. It analogized the scenario before it, in which the parties agreed that there was some covered damage, to that in *Johnson* where it was undisputed that some covered roof damage had occurred.⁶⁴ The *Molzan* court, quoting *Johnson*, stated that “[t]o the extent the parties disagree which [items] needed replacing, that dispute would fall within the scope of appraisal.”⁶⁵ And, following *Johnson*, the *Molzan* court held that “... even if the dispute did involve causation, the [Texas Supreme] court concluded that appraisal

⁵⁹ *Id.* (quoting *Johnson*, 290 S.W.3d at 894, “Litigating the scope of appraisal is wasteful and unnecessary if the appraisal itself can settle [the] controversy.”).

⁶⁰ *Molzan, Inc. v. United Fire & Cas. Co.*, No. H-09-01045, 2009 U.S. Dist. LEXIS 63979 (S.D. Tex. July 23, 2009).

⁶¹ The policy’s appraisal clause regarding property coverage read that “[i]f we and you disagree on the amount of loss, either may make a written demand for an appraisal of the loss[,]” and the business income appraisal clause stated that “[i]f we and you disagree on the amount of Net Income and operating expense or the amount of loss, either may make a written demand for an appraisal of the loss.” See *Molzan*, 2009 U.S. Dist. LEXIS 63979, at *2 n.1.

⁶² *Id.* at *12.

⁶³ *Id.* at *5-6.

⁶⁴ *Id.* at *12.

⁶⁵ *Id.* at *11 (quoting *Johnson*, 290 S.W.3d 886).

was still appropriate.”⁶⁶ Where the appraisal had not yet taken place, appraisal could not be avoided simply because there *might* be a causation question that exceeds the scope of appraisal.⁶⁷

A recent opinion from the 14th Court of Appeals at least pays lip service to the notion that coverage issues are not appraisable. In *In re Security National Insurance Co.*, the Court of Appeals held that that a carrier did not waive its right to seek appraisal by seeking a declaratory judgment as to coverage.⁶⁸ It explained, quoting *Johnson*, that “[a]ppraisal is limited to determining amounts of loss, and not determining whether the insurer should pay[,]”⁶⁹ and it noted that “[a]s a general rule, the sole purpose of an appraisal is to determine the amount of damage.”⁷⁰ These statements were made, however, in the context of a ruling in which the court ultimately compelled appraisal.

VII. CONCLUSION

The most significant change that *Johnson* announces is the notion that, in most instances, appraisal should proceed without judicial intervention, even if a significant coverage issue “may be” present. This creates uncertainty, invites collateral attacks on appraisal awards, and will likely increase the costs and burden associated with appraisal. *Johnson* affirms the traditional view that issues of causation, coverage, and liability are not appraisable. But it makes it harder to get there. There are a number of ways in which parties may try to argue around *Johnson*, but at least in the short term it may be difficult to avoid appraisal if one party demands it. To better protect themselves, parties should consider entering into an appraisal protocol that better defines the scope of appraisal and the form of the appraisal award.

⁶⁶ *Id.* at *9.

⁶⁷ *Id.* at *11, *12, *14 (quoting *Johnson* as stating that “the insured could not ‘avoid appraisal at this point merely because there might be a causation question that exceeds the scope of appraisal.’”).

⁶⁸ *In re Sec. Nat’l Ins. Co.*, No. 14-10-00009-CV, 2010 Tex. App. LEXIS 2911, at *17 (Tex. App.—Houston [14th Dist.], no pet.).

⁶⁹ *Id.* at *17.

⁷⁰ *Id.* (quoting *Johnson*, 290 S.W.3d at 890 n.22).