

NO. A10-714

3

State of Minnesota
In Supreme Court

David and Melynda Quade,

Respondents,

vs.

Secura Insurance,

Appellant.

**BRIEF, ADDENDUM AND APPENDIX OF
APPELLANT SECURA INSURANCE**

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF LEGAL ISSUE/ISSUES

- I. Does a Provision in a Property Casualty Insurance Policy Providing That the Parties are to Engage in an Appraisal Process When They Fail to Agree on “The Amount of the Loss” Require the Parties to Submit Such Disputes to the Appraisal Process When There is a Question Regarding Causation, or is “The Amount of the Loss” a Determination to Be Made By the Courts in Such Cases?**

Noting that “an appraiser’s assessment of the ‘amount of loss’ necessarily includes a determination of the cause of the loss, as well as the amount it would cost to repair that which was lost,” the trial court held in the affirmative and, ruling on Secura’s Motion for Summary Judgment, ordered the parties to participate in the appraisal process as set forth in the policy of insurance between Appellant and Respondents.

The Court of Appeals, reversing the trial court, held that when the cause of property damage is disputed, the courts, not an appraisal panel, must adjudicate the amount of the property damage loss.

Apposite Cases:

Itasca Paper Co. v. Niagara Fire Ins. Co., 175 Minn. 73, 220 N.W. 425 (1928)

American Central Ins. Co. v. Ramsey County, 125 Minn. 374, 147 N.W. 242 (1914)

QBE Ins. Corp. v. Twin Homes of French Ridge Homeowners Ass’n., 778 N.W.2d 393 (Minn. App. 2010)

Sampson v. Horace Mann Ins. Co., 2003 Minn. App. LEXIS 1215 (Minn. App. Sept. 30, 2003)

STATEMENT OF THE CASE

Appellant, Secura Insurance, seeks review of a Minnesota Court of Appeals decision, filed January 11, 2011, that reversed the trial court's Order compelling the parties to participate in an appraisal process set forth in a Farmowners Policy of insurance issued by Secura to Respondents, and its accompanying findings regarding the scope of the appraisal panel's authority in determining the "amount of loss" sustained in a July 10, 2008 windstorm. The underlying litigation is a breach of contract action in which Respondents, David and Melynda Quade, allege that Secura breached a policy of insurance by failing to pay all of the amounts claimed due by Respondents for property damage caused by the windstorm. Although Secura admitted its liability under the policy to pay for storm-related damage, and in fact paid those damages, Secura determined were caused by the storm, Respondents disputed the amount of those payments and disagreed with Secura's assessment that some of the claimed damage was caused by wear and tear and lack of maintenance rather than the storm.

When the parties could not agree on the amount of storm-related damage, Secura requested that the dispute be resolved under a mandatory appraisal process set forth in Secura's policy. *See* Add. 19. In response, Respondents sued for breach of contract to obtain the additional amounts they contend are due for storm damage. App. 1-3. Their Complaint does not seek declaratory relief as to the parties' rights and obligations under the policy or to determine the scope and extent of coverage, but instead contains the single cause of action for breach of contract. *Id.*

On December 3, 2009, Secura moved the Dakota County District Court, the Honorable Martha M. Simonet, Judge of District Court, First Judicial District presiding, for summary judgment and a dismissal of the Complaint on the grounds that the policy terms and applicable law required the parties to submit their dispute as to the amount of storm-related damage to the appraisal process. The district court, over Respondents' opposition asserting that Secura had denied coverage for their claim, granted the motion and directed the parties to engage in the appraisal process to determine the amount of damage caused by the July 10, 2008 windstorm. Add. 11-14. In its Order, the district court specifically held that if a coverage dispute arose after the amount of storm-related loss was determined by the appraisal panel, the parties were free to bring a future action. Add. 11.

The Quades appealed, and Court of Appeals reversed. In its published Opinion, released January 11, 2011, the court held that because damage caused by wear and tear or lack of maintenance was not a covered loss under the policy, the resolution of Respondents' claim "requires the determination of legal questions concerning the meaning and application of contract clauses, causation, and liability," such that the district court erred in ordering the parties to submit the dispute to appraisal. *Quade v. Secura Insurance*, 792 N.W.2d 478 (Minn. App. 2011) (*See Slip Op.* at Add. 10). This Court granted Appellant's Petition for Review on March 29, 2011. Add. 20.

STATEMENT OF FACTS

On July 10, 2008, a windstorm occurred in and around Hastings, Minnesota, damaging buildings and property owned by Appellants. App. 1. At the time of the storm, Respondents David and Melynda Quadé were insured for property damage under a Farmowners Protector Policy (the “Policy”) issued by Appellant, Secura Insurance. App. 10-15. The Policy provides that Secura will pay for direct physical loss caused by windstorms, but also states that Secura will not pay for damage due to faulty or inadequate maintenance, or for pre-existing damage. App. 22, 24, 25, 28.

Following the storm, Respondents submitted to Secura a single claim for damage to all covered property purportedly damaged in the storm incident. App. 2. In response, Secura admitted its liability for storm damage and paid Respondents for damage occurring to their dwelling, two barns, and an auger. App. 45. Secura also agreed to pay for damage to a feeder building if that structure was repaired. App. 45. Respondents, however, claim that additional amounts are due with respect to the items of damage paid by Secura, and also assert that the roofs of three other structures were damaged by the storm and need to be replaced. App. 47, 49-54, 58-60. *See also* Complaint at App. 1-3. Based on two separate evaluations, one by an independent engineer, Secura had determined that claimed damage to the roofs of the three buildings was not caused by the windstorm. App. 46. Specifically, Secura was advised by the engineer that the roofs had deteriorated over time and, as a result, grommets that formed a seal between the metal

roof and the heads of the nails that affixed the roof to the substrate failed, which allowed water to enter around the nail heads. *Id.*

Critical to this case, it is undisputed that Secura did not deny coverage for Respondents' claim. It admitted liability, paid for storm-related damage, and simply disputed the extent of that storm-related damage. App. 2, 6. Recognizing that a dispute as to the amount of the loss existed, Secura invoked an appraisal provision set forth in its policy. App. 48, 55. The appraisal provision is typical of a property casualty policy and states that if the parties do not agree on the amount of loss, each party will select an appraiser to set and agree upon the amount of loss:

8. Appraisal. If you and we fail to agree on the amount of loss, either may demand an appraisal of the loss. In this event, each party will chose a competent appraiser within twenty (20) days after receiving a written request from the other. The two appraisers will choose an umpire. If they cannot agree upon an umpire with fifteen (15) days, you or we may request that the choice be made by a judge or court of record in the state where the residence premises is located. The appraisers will separately set the amount of loss. If the appraisers submit a written report of any agreement to us, the amount agreed upon will be the amount of the loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will set the amount of loss.

Each party will:

- a. Pay its own appraiser; and
- b. Bear the other expenses of the appraisal and umpire equally.

Add, 19; App. 34. Respondents' response was to institute this action for breach of contract to obtain the additional amounts they contend are due for storm damage and to recover additional damages pursuant to Minn. Stat. Section 604.18, a statute that, by its terms, does not apply to claims that are resolved or confirmed outside the district courts.

App. 1-3. The Respondents' Complaint sought to recover damages for breach of contract only, and did not request any declarations by the court. *Id.* Secura answered the Complaint, raised the affirmative defense of the appraisal process and thereafter continued, without success, to seek Respondents' participation in that process. App. 7, 55, 67.

ARGUMENT

I. Standard of Review

On appeal from a grant of summary judgment, the reviewing court must determine whether there are any genuine issues of material fact and whether the district court erred in its application of the law. *STAR Centers, Inc. v. Faegre & Benson, LLP*, 644 N.W.2d 72, 76-77 (Minn. 2002). In this case, the matter was submitted to the lower courts upon undisputed facts, with the issue being the interpretation of the appraisal provision in Secura's policy and the scope of the appraiser's authority thereunder to assess the extent to which Respondents' roofs were damaged as a result of the July 2008 storm. The interpretation of an insurance policy and its application to the facts in a case are questions of law subject to *de novo* review. *American Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn. 2001).

II. Respondents' Claim Against Secura is Subject to the Appraisal Process Because the Sole Dispute Concerns the Amount of the Storm Loss. Any Assessment of the Amount of Loss Necessarily Requires a Determination That Complained of Damage or Loss Was Storm-Related, As Well As the Amount It Would Cost to Repair That Loss, As the Trial Court Properly Concluded.

This appeal concerns whether and to what extent an appraisal panel has the authority under the appraisal provisions in a property casualty insurance policy to make determinations regarding the cause and underlying nature of the damage that is the subject of the claim. The appraisal provision provides that when the insurer and insured disagree on the amount of loss the claim is to be submitted to appraisal, and the appraisal

panel will set the amount of loss. At issue in this case is whether the court system or the appraisal panel process is the appropriate forum to determine the amount of property damage losses when the parties dispute the amount and cause of the loss.

Appraisal provisions like the one in Secura's policy are standard for property casualty insurance policies and have, therefore, been reviewed by Minnesota's appellate courts on numerous occasions, as well as by courts elsewhere. Relying upon this well established body of case law, which was later supplemented by a Minnesota Court of Appeals decision issued the same day the trial court concluded, and properly so, that "an appraiser's assessment of the 'amount of loss' necessarily includes a determination of the cause of the loss, as well as the amount it would cost to repair that which was lost." *See* Add. 13-14. The trial court recognized the purely factual nature of the dispute between the parties, which involved a question of cause and not liability or coverage. Indeed that trial court specifically reserved for future adjudication any issues relating to coverage that might exist upon the conclusion of the appraisal process. Add. 11, 14. Its decision is consistent with both longstanding precedent and the strong policy in Minnesota favoring appraisals.

The Court of Appeals, in its opinion, recognized two critical factors. First, as the court noted, it "is undisputed . . . that the policy covers storm-related damage." Add. 5. In truth, Secura never claimed otherwise. And second, the court recognized that if "the disputed issue is how much of the total claimed damage was caused by the storm, then, . . . , an appraisal is necessary to determine the factual issue of the amount of storm-related loss." *Id.* Although this is precisely the disputed issue, and ignoring that Secura had

admitted liability (and paid) for storm-related damage but disputed the amount of such damage, the Court of Appeals reversed based on the following, perplexing, logic:

Neither the district court nor respondent identifies a fact question free of confusion with regard to legal issues such that if an appraisal occurred, the appraiser would not have to engage in assessing the law and interpreting the policy. In the instant case, questions of fact regarding the effects of a storm and the effects of faulty maintenance are entangled with questions of law respecting the meaning of the contract, the interplay of coverage and exclusions, shifting burdens of proof, and causation, which must be addressed as a matter of law. Determining coverage, causation, and the operation of the exclusion provision requires the attention of the court in a fashion normal for causation questions.

Add. 8.

The Court of Appeals' decision is based on a faulty and, ultimately, irrelevant factual premise -- that Secura denied all liability for coverage of any damage -- and, legally, is unsupported. Its decision both overturns long-standing precedent that amount of loss disputes, which by necessity may include questions (such as causation) that go beyond mere valuation, are subject to the appraisal process, and contravenes Minnesota's strong public policy favoring the appraisal process as speedy and inexpensive means to resolve valuation disputes that avoids costly court fights and expenditure of judicial resources. The practical effect of the court's departure from established law will be to open the Minnesota court system to all property damage amount-of-loss disputes, requiring court determination of the loss each time there is a substantial storm event where the amount of loss is disputed due to non-covered causes such as pre-existing damage or lack of maintenance.

A. Minnesota Has Long Approved of Appraisal as an Inexpensive and Just Means to Determine the Extent of a Loss.

The appraisal provision in Secura’s policy is not a novelty. Like provisions have been included in property casualty policies for well over 100 years as a means to a speedy settlement and adjustment of a loss. *See, e.g., Powers Dry Goods Co. v. Imperial Fire Ins. Co.*, 48 Minn. 380, 51 N.W. 123, 124 (1892). Indeed, the Minnesota Legislature has long mandated that appraisal provisions be included in every policy of insurance issued in the State of Minnesota that insures against the peril of fire, and against damage by hail. *See* Minn. Stat. § 65A.01, subd. 3 (detailing required provisions of Minnesota standard fire insurance policy); Minn. Stat. § 65A.26 (“Every policy of insurance against damage by hail issued by any company, however organized, must provide” that amount of loss disputes will submitted to appraisal, which is “a condition precedent to any right of action to recover for a loss.”).¹

Viewed as a form of arbitration, appraisal provisions, like arbitration, have long been favored in Minnesota. *See American Central Ins. Co. v. Ramsey County*, 125 Minn. 374, 147 N.W. 242, 243 (1914) (noting Minnesota has always adopted the view that “[t]he rules governing arbitrations have been applied to proceedings for determining the amount of loss under insurance policies, and for making appraisements under other forms

¹ This statutory mandate for fire policies has existed since at least 1927, but as early as 1889, the commissioner of insurance was directed by the legislature to prepare a form policy of fire insurance. *See Kavli v. Eagle Star Ins. Co.*, 206 Minn. 360, 288 N.W. 723, 725 (1939) (addressing appraisal provision found at 1 Mason Minn. St. 1927, § 3152). *See also*, Laws 1889, Ch. 217 (“An Act to Provide for a Uniform Policy of Fire Insurance to be made and Issued in This State by all Insurance Companies Taking Fire Risks on Property Within This State”).

of contract, irrespective of whether the persons determining such matters were designated as ‘appraisers,’ ‘referees,’ ‘arbitrators,’ or otherwise.’). *See also Itasca Paper Co. v. Niagara Fire Ins. Co.*, 175 Minn. 73, 220 N.W. 425, 426-27 (1928) (appraisal is in the nature of common law arbitration); *QBE Ins. Corp. v. Twin Homes of French Ridge Homeowners Ass’n.*, 778 N.W.2d 393, 398 (Minn. App. 2010) (“Appraisal decisions are subject to Minn. Stat. § 572.08-.30 (2008), the arbitration statute.”). Minnesota’s public policy favors arbitration because it provides an informal, speedy and inexpensive means of resolving disputes arising between parties whose contract includes an arbitration clause and circumscribes judicial intervention into those disputes. *See, e.g., Dunshee v. State Farm Mutual Automobile Insurance Co.*, 303 Minn. 473, 477, 228 N.W.2d 567, 570 (1975). *See also Beebout v. St. Paul Fire & Marine Ins. Co.*, 365 N.W.2d 271, 272-73 (Minn. App. 1985) (citing *Ramsey County v. AFSCME Council 91*, 309 N.W.2d 785, 790 (Minn. 1981)).² Consistent with this public policy, appraisals have long been viewed as providing a plain, speedy, inexpensive, and just determination of the extent of the loss. *Kavli, supra*, 288 N.W. at 725. This is true not just in Minnesota, but elsewhere as well. *See, e.g., CIGNA Insurance Co. v. Didimoi Property Holdings, N.V.*, 110 F. Supp. 2d 259, 269 (D. Del. 2000) (public policy favors alternative dispute resolution forum of appraisal panel to streamline process and minimize need for costly court intervention); 15

² The strong public policy favoring arbitration, and the legislature’s particular preference that disputes relating to first-party insurance claims be resolved outside of the court system, is further reflected in Minnesota’s Insurance Standard of Conduct Statute, Minn. Stat. § 604.18, which unfortunately appears to be driving this litigation. Specifically, the statute expressly states: “An award of taxable costs under this section is not available in any claim that is resolved or confirmed by arbitration or appraisal.” Minn. Stat. § 604.18, subd. 4(c).

Couch on Insurance 3d § 209:17 (public policy a significant component of insurance law, and public policy of most jurisdictions favors arbitration/appraisals).

B. While Appraisers do not have the Authority to Make Coverage or Liability Determinations, Under Established Minnesota Precedent, an Appraisal Panel's Authority Necessarily Extends to Factual Questions that go beyond Mechanical Calculations of Loss and Include Questions Regarding Causation.

It is within the context of the longstanding favor with which Minnesota views appraisals that the present dispute concerning the scope of the appraisers' authority in determining the amount of a given loss must be considered. The Court of Appeals' decision in this case was based, in part, on the long-standing principle that liability and coverage determinations are the exclusive province of the courts. *See* Add. 6. That proposition, being so well-settled, was never disputed by Secura. But no such liability or coverage dispute is present in this case – Secura has always admitted its obligation to pay for storm damage losses, within the terms of its policy with Respondents, and conversely, Respondents do not contend that Secura must provide coverage for losses occasioned by wear and tear or lack of adequate maintenance. Both sides agree that Secura must pay for storm-related damages and that such storm-related damages are a loss under the policy. Rather, the parties disagree as to the amount of storm-related damage to Respondents' property; and that determination, being purely factual, is the exclusive province of the appraisers.

Citing to *QBE, supra*, the Court of Appeals' decision suggests that Minnesota's courts have never addressed whether the scope of the appraisal panel's authority to set the amount of the loss includes the authority to make determinations regarding the cause of

the loss. *See* Add. at 6. This, however, is not entirely true. As early as 1914, this Court recognized that a proper appraisal requires the appraiser to consider more than just what it would cost to fix specific property:

In the case at bar the appraisers must determine many matters other than the mere value of specific property produced before them for examination and appraisal. They must determine the quantity of property covered by the policy and on hand at the time of the fire, the quantity destroyed, the quantity damaged, **whether the damage resulted from causes covered by the policy** or from other causes not covered thereby, and various other questions, both of law and fact, upon which the parties may differ.

American Central Ins. Co., 147 N.W. at 244 (emphasis added).

In *Itasca Paper Co.*, *supra*, the Court also recognized the authority of an appraisal panel to decide issues beyond mere valuation. Niagara Fire issued a Minnesota standard form policy that insured Itasca Paper against loss by fire of “pulpwood” at a specified location. Following a fire, and a disagreement regarding the amount of loss, the insured demanded an appraisal as provided in the policy, but the insurer refused to participate, claiming that the property involved in the loss was not pulpwood and, therefore, was not covered. *Itasca Paper*, 220 N.W. at 426. The insured applied to the district court for the appointment of an umpire who, along with the appraiser selected by the insured, conducted a hearing and determined both that the damaged property was pulpwood, and that the amount of the loss was just over \$22,000. *Id.* In a subsequent action to recover upon the award, this Court considered the appraisal panel’s authority to evaluate whether the damaged property was pulpwood when determining the amount of the loss. *Id.* at 426. Relying on *American Central*, *supra*, the Court concluded that the appraisal panel’s findings regarding the nature of the property involved was final and conclusive even

though coverage was impacted by those findings. *Id.* at 427. The Court reasoned that while appraisers cannot determine the general question of liability, “questions of law or fact, which are involved as mere incidents to determination of the amount of the loss or damage, do not go to the root of the action” and are, therefore, part of a reasonable method of estimating and ascertaining the amount of the loss. *Id.* at 427.

More recently, the Minnesota Court of Appeals recognized that the appraiser’s role in the appraisal process is not limited to valuation issues. *See Sampson v. Horace Mann Ins. Co.*, No. A03-158, 2003 Minn. App. LEXIS 1215 (Minn. App. Sept. 30, 2003). At issue in *Sampson* was the amount of loss sustained by the insured as a result of a hailstorm. There was no dispute in that case as to liability -- Horace Mann, like Secura has done in this case, acknowledged that it was liable for damage caused by the storm. The parties, however, disputed the nature and extent of the damage. This, according to the court, was “precisely the type of factual dispute the policy’s appraisal process was designed for.” *Id.* at *5. Rejecting the insured’s arguments that the appraiser’s role is limited to resolution of valuation issues and that, before valuation can occur, a fact-finder must decide whether the siding has been dented and must be replaced, the court relied on this Court’s prior pronouncement that “appraisers must determine many matters other than the mere value of specific property produced before them for examination and appraisal.” *Id.* at *6 (quoting *American Cent. Ins. Co.*, 147 N.W. at 244).

Finally, *QBE, supra*, 778 N.W.2d 393 (Minn. App. 2010), concerned a dispute over whether an appraisal panel exceeded its powers and made determinations regarding coverage by concluding that a total roof replacement (as opposed to spot repairs) was

necessary, and in issuing an appraisal award that provided \$264,154 as “loss replacement cost.” In order to make this award, the appraisal panel had to consider a replacement loss formula in the policy and select and apply a valuation method contained therein. *Id.* at 396, 398. Citing to a policy provision which stated that coverage was provided for covered property that is not damaged but must be removed and replaced in order to repair covered property damaged by a covered cause of loss, QBE sought to vacate the appraisal award, claiming that the appraisal panel’s decision constituted an impermissible coverage determination rather than a determination regarding the value of the insured’s loss. *Id.* at 398-99. The court of appeals, however, disagreed. Although the appraisal panel necessarily had to interpret valuation methods set out in the policy, the panel was tasked with valuation and decided only that issue by arriving at a dollar figure representing the value of the loss. *Id.* at 399. Thus, notwithstanding that the appraisal panel’s decision had some impact on coverage, the panel’s decision was within its authority. *Id.*

C. Well Reasoned Decisions from Other Jurisdictions Recognize that Amount of Loss Determinations may, when Necessary, Include Determinations Regarding Causation.

Although courts in other states are conflicted on the issue, those courts that have permitted appraisal panels to decide issues of cause have offered sound reasons for doing so that are consistent with the policy considerations articulated by Minnesota’s courts.

For instance, the trial court’s decision in this case drew heavily from *CIGNA Ins. Co. v. Didimoi Property Holdings, N.V.*, 110 F. Supp.2d 259 (D. Del. 2000), in which the United States District Court for the District of Delaware addressed nearly identical issues. At issue in *CIGNA* was the scope of the appraisal process and the meaning of the phrase

“amount of loss” as used in CIGNA’s policy. The issue arose after a fire caused severe damage to the insured’s office tower, rendering it untenable. CIGNA paid for some of the damage, but a dispute arose over the amount of the loss, including the extent of the fire damage and cost to repair or replace the building. On cross-motions for summary judgment, the insured argued that the phrase “amount of loss” should be narrowly construed to require the appraisers to determine the amount of money necessary to repair or replace the damages claimed without determining the cause of the damages claimed or the amount of the “covered loss.” *Id.* at 262. In response CIGNA argued that insured’s position confused questions of coverage (*e.g.*, whether an event, such as fire, is covered in the first instance) with the concept of determining the scope or amount of loss (*e.g.*, what damage was done by the covered event and the cost to repair that damage) and that the extent of the fire damage was a question concerning the amount of loss appropriately determined in the appraisal process. *Id.* at 263.

Relying on established rules of insurance policy interpretation that are also followed in Minnesota, and the public policy favoring alternative dispute resolution procedures such as appraisal, the federal district court agreed with CIGNA, and determined that the appraisal process should include a determination of whether the claimed damage was caused by the fire. *CIGNA*, 110 F.Supp.2d at 269. In reaching its decision, the court first considered the “plain meaning” of the term “amount of loss,” concluding that, “in the insurance context, an appraiser’s assessment of the ‘amount of loss’ necessarily includes a determination of the cause of the loss as well as the amount it

would cost to repair that which was lost.” *Id.* at 264-65.³ The court based this decision on the definition of “amount of loss” provided in Black’s Law Dictionary, which expressly included a causation element, and upon a definition of “loss” in *Websters Collegiate Dictionary* (9th ed. 1988) that, in the context of insurance, also expressly contemplated causation. *CIGNA*, 110 F. Supp.2d at 264-65.

Next, addressing the insured’s argument that questions relating to cause are coverage issues, the court noted that amount of loss and coverage are separate concepts that should not be confused. Defining coverage as “the assumption of the risk of an occurrence of the event insured against before its occurrence,” the court explained that coverage issues include such questions as “who is insured, what type of risk is insured against, and whether an insurance contract exists.” *CIGNA*, 110 F. Supp.2d at 265 (citing *15 Couch on Insurance* § 212:12). The court recognized that coverage questions, such as whether damage is excluded for reasons beyond fire damage, were legal questions for the court, but factual questions concerning whether a particular item was damaged as a result of fire is appropriately reserved for the appraisal process. *Id.* at 268. It reasoned as follows:

Indeed, under the circumstances of this case, the Court cannot reconcile any other approach. Carried to its logical conclusion, [the property owner and mortgagee’s] position would be nonsensical. If the appraisers were required to accept the insured’s claimed damages regardless of their cause and assign only dollar value assessments to the cost to repair or replace the

³ Minnesota has long followed the “plain meaning” rule of insurance contract interpretation under which the terms of an insurance policy are to be given their plain, ordinary, or popular meaning. *See, e.g., Dairyland Ins. Co. v. Implement Dealers Ins. Co.*, 294 Minn. 236, 199 N.W.2d 806, 811 (1972); *Smith v. St. Paul Fire & Marine Ins. Co.*, 353 N.W.2d 130, 132 (Minn. 1984).

items of claimed damage, the appraisers could be examining damage entirely unrelated to this case. For example, the insured could claim damage that resulted from an office party months ago and the appraisers would be required to assess a repair or replacement cost for that damage, when clearly such damage was not caused by the fire and would not be remotely relevant to this dispute. The Court cannot conclude that this is the appropriate function of the appraisal process.

Id. at 268-69.

Finally, the court considered public policy favoring alternative dispute resolution, commenting:

If the Court were to curtail the appraisers authority to include only dollar value assessments without regard for whether the property was damaged as a result of fire, the Court would be reserving a plethora of detailed damage assessments for judicial review, thereby debunking the purpose of the appraisal which is to minimize the need for judicial intervention.

Id. at 269. *CIGNA* recognizes the inherent problem with taking the approach urged by Respondents to its logical conclusion. The purpose of the appraisal process is to provide a plain, speedy, inexpensive and just determination of the extent of the loss and to discourage costly litigation. *See Kavli, supra*, 288 N.W. 723 at 725. If the parties are required to submit causation determinations to the court, as opposed to the appraisal panel, the court will be forced to fill the role of umpire every time an insurer or insured disputes the amount of the insured's claimed damages occasioned by an admittedly covered cause. This is exactly what the appraisal process is intended to avoid.

While the trial court's decision relied heavily on the analysis in *CIGNA*, the *CIGNA* case does not stand alone. The scope of an appraiser's authority under a similar appraisal provision was addressed by the Massachusetts Supreme Court over half a century ago in *Fox v. The Employers' Fire Ins. Co.*, 113 N.E.2d 63 (Mass. 1953). In that

case, the policy, a “Massachusetts standard policy” insured against direct loss or damage caused by lightning, but expressly excluded loss caused by windstorms. *Id.* at 64A dispute arose over damage to the insured’s garage, and the matter was submitted to an appraisal panel. Evidence presented to the panel tended to show that the damage at issue was caused by lightning and by also windstorm. The panel “determined the amount of loss and damage under said policies to be \$ 317 and the value of the building to be \$ 25,000.” *Id.* at 65. Thereafter the insured sued on the policy for a much larger amount, contending that, by discriminating between loss by lightning and loss by windstorm, the appraisers determined questions of liability and thereby exceeded their authority. The Massachusetts Supreme Court, however, disagreed.

In rejecting the insured’s approach, the Massachusetts Supreme Court first noted that the statutory provision for referral to appraisal had been in the standard policy since 1887, that its purpose was to provide a “summary method of establishing the amount of the loss,” and that the provision should be given a reasonable interpretation to carry out that purpose. *Fox*, 113 N.E.2d at 65-66. The court then stated that it is the “amount of loss or damage under the policy” that the appraisers must determine, not the amount of loss or damage “whether covered by the policy or not” and that “no practical good would be accomplished” by the latter method. *Id.* at 66. It reasoned that “in order to intelligently determine the amount of loss ... under a given policy, as an incidental step in their deliberations, the referees must reach their own conclusions as to what they think that loss or damage is.” *Id.* And while such conclusions necessarily will be affected by what the appraisers think the coverage is, “it is one thing to impeach an award for error of

law and quite another to assert the referees exceeded their authority in confining their award to the loss or damage covered under the policy.” *Id.* at 66. Significantly, while indicating that the appraisers were to set the amount of loss in view of what they think the coverage is, the Massachusetts Supreme Court, citing to this Court’s decision in *Itasca Paper*, recognized that the appraisers “views so far as ultimate liability goes are wholly tentative and in no sense a decision on that underlying question.” *Id.* See also *Augenstein v. Insurance Company of N. America*, 360 N.E.2d 320, 324 (Mass. 1977) (“The *Fox* case indicated that the referees were still to find the amount of loss in light of their own interpretation of the terms of the policy, but the question of construction would remain open for reexamination in an action on the policy, if one should eventuate”). Ultimately the court was unable to accept the contention that the appraisal panel’s determination that the amount of the loss “under said policies” was a determination of contractual liability under the policies rather than a finding of the amount of damages from a specific cause. *Fox*, 113 N.E.2d at 67.

The Florida Supreme Court has, on a number of occasions, also considered the scope of the appraisal panel’s authority. In *State Farm Fire & Cas. Co. v. Licea*, 685 So.2d 1285 (Fla. 1996), for instance, the Florida Supreme Court considered whether an appraisal clause was void for lack of mutuality because it reserved the insurer’s right to later contest coverage. In explaining that the effect of the retained rights clause, the court stated that once there is a demand for appraisal, “the only ‘defenses’ which remain for the insurer to assert are that there is no coverage under the policy for the loss as a whole or that there has been a violation of the usual policy conditions such as fraud, lack of notice,

and failure to cooperate.” *Licea*, 685 So.2d at 1288. In other words, coverage issues are reserved. The court recognized, however, that coverage issues are distinct from amount of loss questions, which can include determinations regarding cause:

We interpret the appraisal clause to require an assessment of the amount of a loss. This necessarily includes determinations as to the cost of repair or replacement and whether or not the requirement for a repair or replacement was caused by a covered peril or a cause not covered such as normal wear and tear, dry rot, or various other designed excluded causes.

Id. at 1288.

Licea was further explained by the Florida Supreme Court in *Johnson v. Nationwide Mut. Ins. Co.*, 828 So.2d 1021 (Fla. 2002), wherein the court resolved a conflict then existing among Florida’s Court of Appeals by holding that causation is a coverage question for the court when the insurer wholly denies that there is a covered loss and an amount-of-loss question when an insurer admits that there is covered loss, the amount of which is disputed. In so doing, the court adopted wholesale the analysis made in one of the court of appeals’ decisions under review:

Very simply, the *Licea* court was saying that when the insurer admits there is a covered loss, but there is a disagreement on the amount of the loss, it is for the appraisers to arrive at the amount to be paid. In that circumstance, the appraisers are to inspect the property and sort out how much is to be paid on account of a covered peril. In doing so, they are to exclude payment for “a cause not covered such as normal wear and tear, dry rot, or various other designated, excluded causes.”

Thus, in the *Licea* situation, if the homeowners’ insurance policy provides coverage for wind storm damage to the roof, but does not provide coverage for dry rot, the appraisers are to inspect the roof and arrive at a fair value for the wind storm damage, while excluding payment for the repairs required by preexisting dry rot.

In the present case (unlike *Licea*) State Farm says that there is no coverage for the claim whatsoever, while the homeowners say that the claim falls within an applicable coverage. Whether the claim is covered by the policy is a judicial question, not a question for the appraisers.

Id. at 1025, (quoting *State Farm Fire & Casualty Co. v. Gonzalez*, 805 So.2d 814, 816-17 (Fla. 3rd DCA 2000). Quite simply, the court recognized that when an insurer wholly denies coverage there is nothing to appraise, but instead there exists a threshold question concerning whether the policy covers the loss, an issue for judicial determination. *Id.*

Most recently, the Texas Supreme Court addressed the scope of the appraisal panel's authority in *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009). The parties in *Johnson* agreed to the established principle that the scope of appraisal includes damage questions and excludes liability questions, but they disagreed which (liability or damages) was involved in their dispute over damage to the insured's roof following a hailstorm. State Farm's inspector concluded that hail had damaged only the ridgeline of the insured's roof, and estimated repair costs at only \$500, while the insured's contractor concluded the entire roof needed replacement. The insured demanded appraisal of the amount of loss, but State Farm refused to participate, arguing that the parties' dispute concerned causation and not the amount of loss. Affirming the Texas Court of Appeals, the Texas Supreme Court concluded that in all but exceptional cases, appraisals should go forward without preemptive intervention by the courts. *Johnson*, 290 S.W.3d 895.

The Texas Supreme Court began its analysis by noting both that appraisal clauses have been included in policies since the nineteenth century, as well the near universality of appraisal provisions in property insurance policies today. *Id.* at 888-89. Yet, despite

the sheer number of policies with appraisal provisions, and the length of time they have existed, such clauses had required the court's attention on only five occasions and never in the context of determining the meaning of "amount of loss." *Id.* at 889. The court took this as an indication that appraisals have for years been effective in resolving amount of loss matters. *Id.*

Next, the court addressed the scope of appraisal, generally. Like Minnesota's courts, the Texas Supreme Court also recognized the long-settled proposition that appraisal is limited to damages, and not liability: "The policy directs the appraisers to decide the 'amount of loss,' not to construe the policy or decide whether the insurer should pay." *Id.* at 890. It then turned to the question of causation, but ultimately concluded that it could not make a determination as to whether the causation dispute presented a question of liability or damages until the appraisal had actually taken place. *Id.* at 893. The Texas Supreme Court's explanation as to why is particularly illuminating.

The Texas Supreme Court explained that "causation relates to both liability and damages because it is the connection between them." *Id.* at 891-92. To support this, it noted that the Texas Pattern Jury Charges place causation in both the broad-form liability questions, and in broad form-damage questions that limit damage to those "resulting" from a particular occurrence. *Id.* at 892. These connections exist throughout Minnesota's Jury Instruction Guides as well. *See, e.g.*, CIVJIG 20.60 (damages for breach of contract); 27.10 (negligence causation); 22.65 (breach of warranty causation); 22.70 (warranty damages). The Texas Supreme Court noted, however, that in actual cases, causation usually will fall in to one category or the other. So, for instance, when

different causes are alleged for a single injury to property, causation is a liability question, but when different types of damage occur to different types of property, appraisers may have to decide the damage caused by each before the courts can decide liability. *Johnson*, 290 S.W.3d at 892. As an example, the court cited an earlier Texas Court of Appeals decision in which appraisers assessed a certain amount for damages due to water, a covered peril, but made no finding for damage due to mold, noting that courts can decide whether water or mold damage is covered, but if they could also decide the amount of damage caused by each, there would be no damage questions left for appraisers. *Id.* at 892. Significantly, the court then described the very scenario this case presents as falling within that latter category:

The same is true when the causation question involves separating loss due to a covered event from a property's pre-existing condition. Wear and tear is excluded in most property policies (including this one) because it occurs in every case. If State Farm is correct that appraisers can never allocate damages between covered and excluded perils, then appraisals can never assess hail damage unless a roof is brand new. That would render appraisal clauses largely inoperative, a construction we must avoid.

Id. at 892-93 (citations omitted). After noting that if appraisers could not take pre-existing wear and tear in to consideration in valuing the amount of loss, it would have reversed a prior court of appeals' decision granting appraisers that authority, the Texas Supreme Court acknowledged that appraisers must, to some degree, always 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 between damages for which coverage is claimed from damages caused by everything else.

Id. at 893 (citations omitted).

The Texas Supreme Court's *Johnson* decision is informative in another respect. Specifically the court took additional care to address timing issues, noting that the case came to it in an unusual posture in that the typical case (true in Minnesota) involves a challenge to an appraisal **after** it has taken place. *Johnson*, 290 S.W.3d at 893-94. Appraisals, however, are intended to take place **before** suit is filed, and are viewed as a condition precedent to suit. *Id.*⁴ The Court commented that it would be a rare case in which appraisal could not take place in less time and expense than it would take to file a motion contesting it. *Id.* Indeed, the appraisal provision in Secura's policy, which was invoked by Secura almost two years ago, requires the parties to select their appraisers within 20 days of a demand, and the umpire selected within 15 days thereafter. Add. 19. In the view of the Texas Supreme Court, allowing litigation about the scope of the appraisal before the appraisal takes place "will surely encourage much more of the same." *Johnson* at 894. And because the appraisal itself may settle the parties' controversy, litigating the scope of the appraisal is "wasteful and unnecessary." *Id.* at 895. The court concludes:

⁴ Secura's policy, for instance, states that "[n]o action can be brought unless the policy provisions have been complied with..." Add. 19. See also *Hamilton v. Liverpool, L. & G. Ins. Co.*, 136 U.S. 242, 254 (1890), quoted, with approval, in *Glidden Co. v. Retail Hardware Mut. Fire Ins. Co.*, 181 Minn. 518, 520, 233 N.W. 310 (1930).

[I]n every property damage claim, someone must determine the "amount of loss," as that is what the insurer must pay. An appraisal clause "binds the parties to have the extent or amount of the loss determined in a particular way." Like any other contractual provision, appraisal clauses should be enforced. There may be a few times when appraisal is so expensive and coverage is so unlikely that it is worth considering beforehand whether an appraisal is truly necessary. But unless the "amount of loss" will never be needed (a difficult prediction when litigation has yet to begin), appraisals should generally go forward without preemptive intervention by the courts.

Id. at 895 (citations omitted). In this case, the trial court likewise recognized the efficiency of proceeding first to appraisal when it specifically reserved for later adjudication issues of coverage and liability on the policy: "Nothing herein will be deemed to prevent either party from, following the appraisal, bringing a declaratory judgment action on any coverage issue **if there exists a coverage dispute at that time.**"

Add. 11 (emphasis added).

D. The Appraisers' Authority to Set the Amount of Loss Includes the Authority to Make Determinations Regarding Cause. The Court of Appeals' Decision in this Case Holding Otherwise is Based on a Flawed Factual Premise, is Legally Flawed, and Implicates Serious Public Policy Concerns Regarding the Role of the Courts in Deciding Valuation Questions.

Based on Minnesota's strong public policy favoring appraisals as a means to a speedy, inexpensive and just resolution of amount of loss disputes, this Court's prior recognition that determining the amount of loss must encompass more than a mechanical valuation of the damage claimed, and the well reasoned decisions of the courts in Florida, Massachusetts, Texas and Delaware, it is entirely within the appraisers' mandate to make assessments regarding cause in evaluating the amount of loss. Such assessments, while

conclusive as to the factual question of damages, are neither coverage determinations, nor determinations as to liability, both of which remain exclusively with the court.

The Court of Appeals' decision is both legally and factually flawed, and must be reversed. The court cites as the basis for its decision that "neither the district court nor [Secura] identifies a fact question free of confusion with regard to legal issues such that if an appraisal occurred, the appraiser would not have to engage in assessing the law and interpreting the policy." Add. 8. Yet, the Court of Appeals fails to explain in its decision how "questions of fact regarding the effects of the storm and the effects of faulty maintenance [*i.e.*, the cause of the claimed loss] are entangled with questions of law respecting the meaning of the contract, the interplay of coverage and exclusions, shifting burdens of proof, and causation...." *Id.* The decision appears to be based on confusion between issues of coverage, which concerns whether an event is within the scope of the policy to begin with, and "amount of loss."

In short, there are no coverage issues implicated by the referral to appraisal. There is no dispute that the policy covers storm damage but does not cover loss to property caused by faulty or inadequate maintenance or wear and tear. There is no dispute regarding the meaning of wear and tear. Respondents do not contend that the policy is ambiguous and therefore in need of judicial interpretation. The case presents a simple fact question -- what is the amount of the loss from the July 10, 2008 windstorm? In answering this question, the appraisers will not be required to in any way interpret the policy or make determinations regarding Secura's liability to Respondents. And while cases such as *QBE* and *Fox* suggest that appraisers have some leeway in interpreting the

policy anyway, in this case there is no reason that the appraisal panel would ever have to even look at the Secura policy in order to determine the amount of the storm loss.⁵

Factually, the Court of Appeals' decision is based entirely on its mischaracterization of the present dispute as one in which Secura denied all liability for coverage of any damage -- a mischaracterization of fact that was the premise for Respondents' entire argument concerning whether appraisal was appropriate. Add. 8-9. This, however, simply ignores the fact that Secura admitted liability -- and paid Respondents -- for the damages to Respondents' property that Secura determined to be caused by the storm. Respondents have attempted to skirt this reality by parsing out their claim on a building by building basis, arguing that somehow their claim for damages to the roofs of the pole buildings is separate and distinct from their claim for damages to the rest of their property. The fact of the matter is that Respondents have one claim for all of the property damage resulting from the July 10, 2008 wind storm. Secura agreed it was liable for storm-related damage and paid Respondents for storm-related damage. The parties simply do not agree that all of the damage claimed is storm-related.

Regardless, however, the opinion is legally flawed. While Florida and Texas would require the insurer to admit there is a covered loss under its policy (which Secura

⁵ The purely factual nature of the dispute is clear. If this case were to proceed in the district court, it would be a jury, not the court, who would decide the amount of the storm damage. Each party would present expert testimony, likely using the very expert who would have served as that party's appraiser, and the jury would take on the role of the neutral appraiser. This type of costly and time consuming damages evaluation is precisely what the appraisal clause was intended to avoid.

did in this case), a similar requirement does not exist in Minnesota.⁶ In *Itasca Paper*, *supra*, this Court considered the rights of an insurer and an insured to have an award of the loss fixed by arbitrators, whether liability be admitted or denied. The Court refused to curtail the appraisal process simply because the insurer denied coverage:

Defendant contends that a denial of liability solely upon the ground that the policy does not cover the destroyed or damaged property operates as a bar to the right of the insured to demand any appraisal whatsoever. Such contention is contrary to the holding in *Abramowitz v. Continental Ins. Co.*, 170 Minn. 215, 212 N.W. 449 (1927). If so, it would be an effective and simple way to destroy the insured's right of appraisal.

Id. at 427, *cited in Orient Ins. Co. v. Skellet Co.*, 28 F.2d 968 (8th Cir. 1928). It stands to reason that the insurer has equal right to appraisal to determine the amount of the loss and that an insured should not avoid the appraisal process simply by alleging a coverage issue.

Even a complete denial of liability will leave a basis for an arbitration where there is a controversy between the parties as to the amount of the loss. *Itasca Paper Co.*, 220 N.W. at 427-428; *Cash v. Concordia Fire Ins. Co.*, 111 Minn. 162, 126 N.W. 524 (1910) (holding that the case presented not a failure to agree as to the amount of the loss, but an unequivocal denial of all liability, leaving no issue to arbitrate). In summary, neither the mere specter of a potential coverage issue, nor the fact that the appraisers' decision might later come shoulder-to-shoulder with subsequent legal questions is

⁶ Nor, apparently, does such a requirement exist in Massachusetts. While recognizing that appraisers do not have the right to determine whether a loss, if sustained, is covered by the policy, whether the policy had taken effect, or other questions pertaining to liability, the "right to determine 'the amount of loss' carries with it by necessary implication the right to determine that none existed." *See F. & M. Skirt Co. Inc. v. Rhode Island Ins. Co.*, 316 Mass. 314, 316 (1944), *quoted in Fox, supra*, 113 N.E.2d at 66.

sufficient to curtail the appraisal process. So long as the parties dispute the amount of the loss, the amount of the loss shall be determined by the appraisal process set forth in the policy, regardless of whether there is a partial or complete denial of liability. Inasmuch as an appraisal award setting the amount of loss from the storm neither determines liability, nor precludes either party from subsequently having Secura's liability on the policy judicially determined, the Court of Appeals was wrong to reverse the trial court.

CONCLUSION

The trial court's decision to refer the present dispute to the appraisal process, while reserving for later adjudication any issues regarding liability or causation that might exist once the appraisal is complete, fully comports with over 100 years of jurisprudence, both in Minnesota and elsewhere, favoring the appraisal process as an inexpensive, speedy and just means to resolve amount of loss disputes. It recognized the dispute for what it is -- a factual dispute over the extent of the loss sustained in the July 2008 windstorm, and not a dispute over whether Secura is liable for the claimed loss.

The Court of Appeals' conclusion that the parties' dispute over the extent of the storm damage presents questions of coverage is erroneous and has serious implications for the court system. Its decision (1) overturns long-standing precedent that amount of loss disputes are subject to the appraisal process and by necessity may include considerations beyond the mechanical calculation of repair costs; (2) contravenes Minnesota's strong public policy in favor of the appraisal process as a means to resolve valuation disputes in a speedy and inexpensive manner while avoiding costly court fights

and expenditure of judicial resources; and, (3) in practical effect, opens the floodgates for litigation in Minnesota's courts of all property damage amount-of-loss disputes, requiring court determinations in every case in which the amount of the loss is disputed due to non-covered causes such as pre-existing damage or lack of maintenance. For all of the reasons stated above, Appellant Secura Insurance respectfully requests that the decision of the Court of Appeals be reversed, and the judgment of the trial court reinstated.

Respectfully submitted,

COUSINEAU McGUIRE CHARTERED

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