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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2016-003737 11/07/2017

HONORABLE DANIEL J. KILEY

CLERK OF THE COURT
C. Mai
Deputy

TRANSPACIFIC DEVELOPMENT COMPANY, et al. MICHAEL N POLI

v.

LEXINGTON INSURANCE COMPANY, et al. RANDY LEE KINGERY

BRET S SHAW
STEVEN G MESAROS

UNDER ADVISEMENT RULING

This case concerns an insurance claim for property damage to four buildings owned by Plaintiffs Transpacific Development Company *et al*. (collectively, "Transpacific"). Transpacific alleges that each of the buildings sustained damage to its modified bitumen roof as a result of a hailstorm on October 5, 2010. At the time, Transpacific's buildings were insured by a policy (the "Policy") with Defendant Lexington Insurance Company ("Lexington"). The Policy provides in part:

> Except as otherwise provided in this Paragraph, adjustment of loss or damage under this Policy shall be valued at the cost to repair or replace (whichever is less) at the time and place of the loss with materials of like kind and quality, without deduction for depreciation or obsolescence.

Policy at p. 9, attached as Exhibit A to Plaintiffs' Separate Statement of Facts in Support of Response to Motion for Partial Summary Judgment Re: Appraisal ("PSOF").

Section VII, ¶ 3 of the Policy (the "Appraisal Clause") provides:

> If the Company and the Insured disagree on the value of the property or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser. The two appraisers will select an umpire…The appraisers will state separately the replacement cost and actual cash value of the property and amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding.

Id. at p. 22.

When the parties could not agree on the amount of the loss resulting from the hail storm, Transpacific and Lexington each selected an appraiser (Dave Fix and Dave DeLacy, respectively), who then jointly selected an umpire, Michael Murphy. The appraisers and the umpire (collectively, the "Panel") participated in an appraisal process, at the conclusion of which the Panel issued an award (the "Appraisal Award") that Transpacific's appraiser, Mr. Fix, refused to sign.

In its Complaint, Transpacific asserts, *inter alia*, that Lexington has breached its duty "to make payments owed to [Transpacific] for the Loss sustained as a result of the Hailstorm - - specifically, payments owed to repair and/or replace the damaged property with materials and construction of like kind and quality to restore the damaged property to its pre-loss condition." Complaint at ¶ 56.

Lexington seeks summary judgment on the validity of the Appraisal Award, asking the Court to determine, "as a matter of law," that "the appraisers and umpire…did not exceed their authority in the appraisal process to decide the amount of the loss…" Defendant Lexington Insurance Company's Motion for Partial Summary Judgment Re: Appraisal ("MSJ Re: Appraisal") at p. 1. In response, Transpacific argues that the Appraisal Award "is predicated on" repairing the roofs by applying "an elastomeric coating" that would be tantamount to putting "a 'band-aid' over the damaged roofs," and that the Appraisal Award therefore "violate[s] the Policy's requirement to repair or replace damaged property with materials of like kind and quality." Plaintiffs' Response to Defendant Lexington's Motion for Partial Summary Judgment Re: Appraisal ("Response to MSJ Re: Appraisal") at pp. 8, 10.

It is true, as Lexington asserts, that Arizona joins "the majority national view" that "appraisals are given general finality as to valuation" and "that appraisers are given wide latitude to determine value." MSJ Re: Appraisal at p. 4. An appraiser's powers are not, however,

unlimited. An appraiser may not, for example, "resolve questions of coverage and interpret provisions of the policy." *Hanson v. Commercial Union Ins. Co*., 150 Ariz. 283, 286, 723 P.2d 101, 104 (App. 1986) (citation and internal quotations omitted). Because appraisals are accorded the same degree of finality as decisions by arbitrators, *Hirt v. Hervey*, 118 Ariz. 543, 545, 578 P.2d 624, 626 (App. 1978), the principle that an arbitrator's determination may be challenged if the arbitrator exceeded his or her powers applies to appraisals as well. *See* A.R.S. § 12-1512(A). Likewise, as the Arizona Court of Appeals has recognized, an arbitrator's decision may be challenged to the extent the arbitrator exceeded limits imposed on his or her discretion by the arbitration provision. *Hirt*, 118 Ariz. at 545, 578 P.2d at 626 ("Apart from questions of fraud or corruption, the decisions of arbitrators on questions of fact and of law are final and conclusive, *except when they conflict with express guidelines or standards set forth or adopted in the arbitration agreement*.") (emphasis added, citation and internal quotations omitted); *Allstate Ins. Co. v. Cook*, 21 Ariz.App. 313, 315, 519 P.2d 66, 68 (1974) ("An arbitrator's authority is generally circumscribed by the agreement from which his power to act is derived.").

Here, Transpacific argues that the Appraisal Award is the product of the Panel's failure to apply the "like kind and quality" provision of the Policy. In support of its assertions on this point, Transpacific has presented evidence, *inter alia*, that the Appraisal Award was based on the cost of applying an elastomeric coating to the damaged roofs and that an elastomeric coating would not have the same life expectancy as the modified bitumen roofs had in their original condition. The evidence Transpacific has presented on this point includes the form of an email from Mr. DeLacy, Lexington's appraiser, to Lexington's Keith Grant stating that the Umpire "is leaning to applying an elastomeric coating to each [building]," and adding the following caveat:

> The caveat to this is that the 860 building had a new roof applied 3 years ago prior to the storm, and thus would have had an additional 12 to 17 year life to it had the hail not hit, the elastomeric coating only has a ten year warranty to it, thus *we would be short on giving the insured back the life expectancy he would have had* so may have to come up with another solution on how to solve that issue.

PSOF at ¶ 26 and Exhibit N thereto(emphasis added).

Transpacific has also presented evidence that Lexington's Claims Examiner Ossian Cooney admitted in deposition testimony that the "like kind and quality" provision requires that the repaired property have the same expected lifetime as the property in its original state. PSOF at ¶ 39 and Exhibit D thereto at p. 16. Additionally, Transpacific has presented evidence that Lexington's own employees have acknowledged that the elastomeric coating would not restore the damaged modified bitumen roof to its original lifespan. A July 23, 2014 note in the claims log by Lexington's adjuster Keith Grant, for example, states in part,

> …The Umpire is leaning towards allowing hail damage to roofs 7805 & 860 buildings [*i.e.*, two of the Plaintiff's four buildings], with a repair of an elastomeric coating. *This raises the issue of the life expectancy of the elastomeric coating versus the original roof covering on the building at the time of the loss* at the 860 building. This building had a new roof three years prior to the storm, *the roof would have 12-17 year life span at the time of the storm. The coating only has a 10 year warranty*.

PSOF at ¶ 27 and Exhibit G thereto at p. LEX000045 (emphasis added).

Lexington takes the position that Transpacific's evidence on this point cannot be considered because the basis for the Appraisal Award is immune from review.[1] The Court disagrees. If the Panel determined the amount of loss without considering the cost to repair or replace with materials of like kind and quality, the Panel exceeded the scope of its authority under the Policy, and the Appraisal Award may properly be challenged on that basis. *See* A.R.S. § 12-1512(A)(3) ("[T]he court shall decline to confirm an award and enter judgment thereon where…[t]he arbitrators exceeded their powers."). *See also Franco v. Slavonic Mut. Fire Ins. Ass'n*, 154 S.W.3d 777, 786 (Tex.App. 2004) ("[T]he results of an otherwise binding appraisal may be disregarded…when the award was not in compliance with the requirements of the policy."); *Jefferson Ins. Co. v. Superior Court*, 475 P.2d 880, 883 (Cal. 1970) ("Since the evidence shows that the appraisers misinterpreted the meaning of 'actual cash value' and therefore failed to decide the factual issue submitted to them, the insured properly invoked the jurisdiction of respondent court to vacate the award…"). The Court finds that, at a minimum, factual questions precluding summary judgment exist as to whether the Panel did, in fact, fail to apply the "like kind and quality" requirement of the Policy in making their Appraisal Award. Accordingly,

[1] At Oral Argument on September 22, 2017, counsel for Lexington appeared to suggest that the Panel was not bound to apply the "like kind and quality" provision of the Policy because that phrase does not appear in the "Appraisal" provision of the Policy. While it is true that the phrase "like kind and quality" does not appear in the "Appraisal" provision, *see* Policy at p. 9, attached as Exhibit A to PSOF, that does not mean that the Panel was free to determine the value of the loss without regard to whether the materials used to repair or replace were of "like kind and quality." On the contrary, the Policy clearly promises the insured that "adjustment of loss or damage under this Policy" was to be "valued at the cost to repair or replace…with materials of like kind and quality," *id*. at p. 9, and the Panel had no authority to ignore that requirement in making its Appraisal Award.

IT IS ORDERED denying Defendant Lexington Insurance Company's Motion for Partial Summary Judgment Re: Appraisal.

Transpacific asserts claims against Lexington for Breach of Contract/Breach of Covenant of Good Faith and Fair Dealing, Tortious Bad Faith, and Declaratory Relief. In its claim for Declaratory Relief, Transpacific seeks a declaration that the Appraisal Award is "not binding" because "Plaintiffs have not voluntarily waived their Constitutional rights to a jury trial of their claims arising under or pertaining to the Policy." Complaint at ¶ 70.

Lexington asserts that, as a matter of law, the Appraisal Clause in the Policy "does not violate Plaintiffs' constitutional right to a jury under Article 2, § 23 of Arizona's Constitution." Defendant Lexington Insurance Company's Motion for Partial Summary Judgment Re: Jury ("MSJ Re: Jury") at p. 1. Noting that the Appraisal Clause was "indirectly mandated and incorporated" into the Policy "pursuant to A.R.S. § 20-1503(A)," Lexington asserts that "the statutory obligation for an appraisal" does not run afoul of the constitutional right to a jury because a party has no "right to an Arizona jury…to set the value of a loss under an insurance contract." *Id*. at pp. 2, 6. In support of this assertion, Lexington argues that Article 2, § 23 of the Arizona Constitution guarantees the right to a jury "only in those matters in which [the right to a jury] existed under the common law," and "no right to a jury for appraisals existed before Arizona's constitution was adopted." *Id*. at p. 4. Lexington argues that, in the alternative, Transpacific waived its right to a jury trial by failing to timely assert it, *i.e*., by participating in the appraisal process "without any hint of objection based on an alleged right to a jury." *Id*. at p. 13.

In response, Transpacific acknowledges that the Appraisal Clause was "mandate[d]" by A.R.S. § 20-1503(A), but nonetheless asserts that, the provisions of A.R.S. § 20-1503(A) notwithstanding, Article 2, § 23 of the Arizona Constitution guarantees Transpacific the right to a jury trial on its claims. Plaintiffs' Response to Motion for Partial Summary Judgment Re: Jury Issues ("Response to MSJ Re: Jury") at p. 16. Transpacific further argues that it did not waive its right to a jury trial by participating in the appraisal process, asserting that it was "compelled" to do so at the "risk" of "being found to have violated the terms of the [P]olicy." *Id*. Transpacific concludes that, because it did not "voluntarily waive [its] Constitutional rights to a jury trial of [its] claims…the Appraisal Award is not binding on, nor does it have any preclusive effect upon," Transpacific's claims. *Id*. Transpacific cites case law from other jurisdictions in support of its position on this point. *Id*. at p. 17, *citing*, *e.g*., *Massey v. Farmers Ins. Grp*., 837 P.2d 880, 885 (Okla. 1992) ("Because Art. 2, § 19 of the Oklahoma Constitution provides for the right of jury trial to be and remain inviolate, we…conclude that legislative narrowing of the claims process is not effective to deny a party their right to have all fact issues decided by a jury.").

At the outset, the Court notes that the Appraisal Clause does not purport to encompass all disputes and claims between the parties. Nothing in the Appraisal Clause, for example, purports

to encompass tort claims, and so nothing in the Appraisal Clause could be read to encompass Transpacific's claim for Tortious Bad Faith. *See So. Cal. Edison Co. v. Peabody W. Coal Co.*, 194 Ariz. 47, 51, 977 P.2d 769, 773 (1999) ("Although it is commonly said that the law favors arbitration, it is more accurate to say that the law favors arbitration of disputes that the parties have agreed to arbitrate."). *See also Cook*, 21 Ariz.App. at 315, 519 P.2d at 68 ("Parties are only bound to arbitrate those issues which by clear language they have agreed to arbitrate; arbitration agreements will not be extended by construction or implication.") (citation, internal quotations, and internal punctuation omitted). Because the parties entered no agreement that purported to impose any limit on their right to seek relief in tort, the Court sees no basis on which to find that Transpacific is in any way precluded from asserting its claim for Tortious Bad Faith against Lexington at trial, or from having a jury determine the full amount of compensatory and punitive damages, if any, to which Transpacific is entitled as a result of Lexington's alleged Bad Faith.[2] The Court therefore agrees with Transpacific that, as to its Tortious Bad Faith claim, the Appraisal Award does not bind the jury or limit its authority to determine the full amount of damages, if any, to be awarded.

The applicability of the Appraisal Clause to Transpacific's contract claims - - *i.e.*, whether the amount Transpacific can recover on its contract claims can be fixed by an appraisal rather than determined by a jury - - is a more difficult matter. It is true that the law recognizes the validity of appraisal agreements similar to that at issue here, and generally accords binding effect to the appraisal awards. *See, e.g., Hirt*, 118 Ariz. at 545, 578 P.2d at 626. A valid and binding appraisal award would, therefore, bar Transpacific from recovering damages in a higher amount on its contract claims. *See, e.g., Franco*, 154 S.W.3d at 786, 787 (holding that "[t]he effect of an appraisal provision is to estop one party from contesting the issue of damages in a suit on the insurance contract, leaving only the question of liability," and that, because the insureds accepted payment from the insurer, insureds "are estopped by the appraisal award from maintaining a breach of contract claim against [insurer].").

For several reasons, however, the Court finds it premature to resolve the parties' dispute over whether the Appraisal Clause is binding as to Transpacific's contract claims. First, as noted above, the Court finds issues of fact precluding summary judgment on whether the Appraisal Award is binding. Until a binding appraisal award is entered, it would be premature for the Court to rule on what effect such an award would have on Transpacific's contract claims.

[2] Lexington appears to concede as much by stating that the Appraisal Clause "does not affect a right to a jury on any other type of claim, i.e., as to coverage questions or bad faith claims." Defendant Lexington Insurance Company's Reply in Support of Its Motion for Partial Summary Judgment Re: Jury at p. 5.

Second, before the Court can address the constitutional challenge Transpacific raises to A.R.S. § 20-1503(A), the Court must first determine whether Transpacific, by its conduct, waived its right to a jury trial. This is because courts are required to "decide cases on nonconstitutional grounds if possible, avoiding resolution of constitutional issues, when other principles of law are controlling and the case can be decided without ruling on the constitutional questions." *Fragoso v. Fell*, 210 Ariz. 427, 430, 111 P.3d 1027, 1030 (App. 2005) (citation and internal quotations omitted). The Court cannot, however, resolve the "waiver" issue on the present record. Whether Transpacific intended to waive its right to a jury trial must be determined based on Transpacific's intent at the time the Policy containing the Appraisal Clause was entered into, not after the October 5, 2010 hail storm that gave rise to the claim. *See Malad, Inc. v. Miller*, 219 Ariz. 368, 372, 199 P.3d 623, 627 (App. 2008) ("We interpret a contract based on the parties' intent upon entering the agreement, not their intent after the fact."). While the parties have presented conflicting evidence about whether Transpacific participated in the appraisal process voluntarily[3], they have presented no evidence of the circumstances surrounding the parties' entry into the Policy, or whether Transpacific made any objection to the Arbitration Clause *at that time*.

Third, the Court cannot resolve a constitutional challenge to a statute until A.R.S. § 12-1841 is first complied with; there is no indication that that has occurred in this case. *See* A.R.S. § 12-1841(1) (providing that certain state officials "shall" be given an opportunity "to be heard" in "any proceeding in which a state statute…is alleged to be unconstitutional.").

Accordingly, until a determination is made that an appraisal award was made that comports with the terms of the Policy, including its "like kind and quality" provision; a more complete record on the "waiver" issue is presented; and A.R.S. § 12-1841 is complied with, the Court cannot resolve the parties' dispute over the effect of the Appraisal Clause on Transpacific's contract claims.

Based on the foregoing,

[3] *Compare* Declaration of Ossian Cooney at ¶ 2 ("Lexington…never received any communication from plaintiffs…objecting to or resisting the appraisal process…As the claim professional assigned to this claim, any notice of objection would have been directed to me…"), attached as Exhibit 4 to Defendant Lexington Insurance Company's Statement of Facts in Support of Its Motion for Partial Summary Judgment Re: Jury *with* Declaration of Vincent Curci at ¶ 8 ("Lexington…invoked the insurance policy's appraisal clause…and we went into appraisal over my objection. At no point did I, on behalf of [the plaintiffs], voluntarily participate in the appraisal process."), attached as Exhibit B to Plaintiffs' Separate Statement of Facts in Support of Response to Motion for Partial Summary Judgment Re: Jury.

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IT IS ORDERED denying Defendant Lexington Insurance Company's Motion for Partial Summary Judgment Re: Jury.