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Property Insurance Law

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Appraisal Demands Do Not Relieve Policyholders of Their Post Loss Duties

In a case of first impression, an Illinois court held that a policyholder's demand for contractual appraisal of the amount of loss of its property insurance claim does not suspend its post loss duties under the insurance policy. *McGraw Prop. Sols. LLC v. Westchester Surplus Lines Ins. Co*., No. 22-cv-00396, 2024 WL 1702680, at *1 (N.D. Ill. Apr. 19, 2024). Specifically, relevant to coverage practitioners is the court's finding that a policyholder must sit for a timely requested examination under oath and produce documentation requested by the insurer as a condition precedent to appraisal. *McGraw Prop. Sols. LLC*, 2024 WL 1702680, at *1.

Overview of Relevant Policy Provisions

At issue in *McGraw* were three contractual provisions that appear in nearly every property insurance policy issued in Illinois. First, is the "Post Loss Duties" provision, which generally enumerates a series of contractual duties that an insured must comply with following a loss and during the investigation and adjustment of its claim. An example of such language is as follows:

> 3. Duties In The Event of Loss Or Damage
>
> a. You must see that the following are done in the event of loss or damage to Covered Property:
>
> (6) As often as may be reasonably required, permit us to inspect the property proving the loss or damage and examine your books and records. Also, permit us to take samples of damaged and undamaged properly for inspection, testing and analysis and permit us to make cables from your books and records.
>
> (8) Cooperate with us in the investigation or settlement of the claim.
>
> b. We may examine any insured under oath, while not in the presence of any other insured and at such times as may be reasonably required, about any matter relating to this insurance or the claim, including an insured's books and records.

The above policy provisions obligate an insured that has filed a claim to produce documents requested by its insurer, sit for an examination under oath ("EUO") and generally cooperate with the insurance company while it investigates the policyholder's claim. The insured's duty to cooperate arises from the fact that the insurer usually has little or no knowledge of the facts surrounding a claimed loss, while the insured has exclusive knowledge of such facts, resulting in

the insurer being dependent on its insured for fair and complete disclosure. *Piser v. State Farm Mut. Auto. Ins. Co*., 405 Ill. App. 3d 341, 345-46 (1st Dist. 2010). A policy's EUO and other post loss duty requirements allow an insurer to "possess itself of all knowledge, and all information as to other sources and means of knowledge, in regard to the facts, material to their rights, to enable them to decide upon their obligations, and to protect them against false claims." *Passero v. Allstate Ins. Co*., 196 Ill. App. 3d 602, 607 (1st Dist. 1990) (*quoting Claflin v. Commonwealth Ins. Co*., 110 U.S. 81, 94–95 (1884)).

The second policy provision at issue in *McGraw* was the policy's appraisal provision. By statute, every insurance policy issued by an admitted carrier in Illinois must contain an appraisal provision. Such provisions usually employ the following language:

> 2. Appraisal
>
> If we and you 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. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the 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. Each party will:
>
> a. Pay its chosen appraiser; and
> b. Bear the other expenses of the appraisal and umpire equally.
>
> If there is an appraisal, we will still retain our right to deny the claim.

In the insurance context, appraisal is most often used to determine the amount of the loss sustained under a property insurance policy. *FTI Int'l, Inc. v. Cincinnati Ins. Co.*, 339 Ill. App. 3d 258, 260–61 (2nd Dist. 2003). Appraisal is far more limited than arbitration, which is quasi-judicial and can resolve a dispute in its entirety. *70th Ct. Condo Ass'n v. Ohio Sec. Ins. Co*., No. 16-cv-07723, 2016 WL 6582583, at *4 (N.D. Ill. Nov. 7, 2016). An appraisal does not require a hearing or any judicial discretion; in fact, appraisers are generally expected to act on their own skill and knowledge. *70th Ct. Condo Ass'n,* 2016 WL 6582583, at *4. Despite these important differences, Illinois courts view appraisal clauses as analogous to arbitration clauses and hold that both types of clauses are valid and enforceable in a court of law. *Lundy v. Farmers Grp., Inc*., 322 Ill. App. 3d 214, 218–19 (2nd Dist. 2001). As a general rule, Illinois courts strongly favor the resolution of non-coverage related questions through the appraisal process, ostensibly as an efficient manner of resolving disputes as amounts of loss the underlying insurance claim.

The third and final policy provision at issue in *McGraw* was the "Legal Action Against Us" provision. These provisions employ nearly uniform language across all types of property insurance policies in Illinois and provide as follows:

> F. LEGAL ACTION AGAINST US
> No one may bring a legal action against us under this Coverage Part unless:
>
> There has been full compliance with all of the terms of this Coverage Part; and

The action is brought within 2 years after the date on which the direct physical loss or damage occurred.

The purpose of such provisions is twofold. First, an insured is required to both present and file legal action on any property insurance claim within two years of the underlying date of loss or damage. *See generally, Wabash Power Equip. Co. v. Int'l Ins. Co.*, 184 Ill. App. 3d 838, 845 (1st Dist. 1989). Additionally, such provisions mandate an insured's compliance with all other policy provisions as a condition precedent to any litigation on the policy. *Norman v. Standard Fire Ins. Co.*, No. 2:22-cv-021992023, WL 6018919, at *6 (C.D. Ill. May 15, 2023)

McGraw v. Westchester

In a recent and well-reasoned decision, the U.S. District Court for the Northern District of Illinois held that notwithstanding a policyholder's demand for appraisal, it was still contractually obligated to cooperate with its insurer, produce requested documentation and sit for an EUO. *McGraw Prop. Sols. LLC,* 2024 WL 1702680, at *1. The facts underpinning the decision are relatively straightforward. The plaintiff, McGraw Property Solutions, LLC was the assignee of Atlas Holdings Investment, LLC, which in turn was the named insured under a policy of property insurance issued by Westchester Surplus Lines Insurance Company. Atlas filed a claim with Westchester relative to storm damage to its commercial property in Glenview, Illinois that occurred on April 7, 2020. Atlas then assigned its claim to McGraw, which proceeded to seek policy proceeds from Westchester for purported storm-related property damage. *Id.* at *2.

As part of its investigation, Westchester engaged an engineering firm to examine the property, determine the cause of loss and promulgate a scope, means and method of repair. *Id.* While the engineering firm engaged by Westchester recommended replacements and repairs to the roofing system, the parties disagreed as to the cause of the underlying damage necessitating those repairs. Specifically, McGraw pointed to the April 7, 2020 storm event, while Westchester pointed to the engineering findings, which indicated that the roof damage likely occurred as a result of several hail and wind events occurring in the years prior to the at-issue policy period. *Id.* As often happens when parties dispute loss causation in the context of a property insurance claim, the policyholder demanded appraisal. Westchester responded and informed McGraw that the appraisal demand was premature because the coverage investigation remained ongoing. *Id.* at *2. As part of that coverage investigation, and within five days of receipt of the appraisal demand, Westchester demanded an EUO of McGraw. *Id.* Westchester would later supplement that EUO demand with a demand for McGraw to produce certain categories of documentation relevant to the insurer's investigation of the timeline and extent of the claimed storm damage. *McGraw Prop. Sols. LLC,* 2024 WL 1702680, at *2.

After initially agreeing to appear for an EUO, McGraw subsequently filed suit against Westchester, lodging counts for breach of contract and declaratory judgment. McGraw contended Westchester breached the policy by its alleged refusal to participate in the appraisal process and repair covered damage. *Id.* at *1. Westchester counterclaimed for declaratory judgment, asserting that McGraw breached the policy by refusing to appear for the demanded EUO. Westchester subsequently moved for summary judgment, arguing that McGraw failed to satisfy a condition precedent to suit on the policy by failing to appear for the demanded EUO and to produce the requested documents. The district court agreed, granting summary judgment to Westchester. *Id.*

Prejudice to Insurer Established When Claimant Refuses to Appear for Examination Under Oath and Produce Relevant Documentation

In relevant part, the court looked to the policy provision that provided "an insured cannot bring a legal action against the insurer until 'there has been full compliance with all of the terms of this Coverage Part.'" *Id.* at *4. It further noted that those coverage terms included an obligation on McGraw's part to both cooperate with Westchester and appear for an EUO as often as reasonably required. *Id.* The court proceeded to analyze coverage under the traditional cooperation clause analysis, which generally provides that an insured's failure to cooperate with the insurer provides a valid defense to a breach of contract claim but only when the insured's breach substantially prejudices the insurer's defense or investigation. *See generally, Piser,* 405 Ill. App. 3d at 347.

The court agreed with Westchester that McGraw's failure to appear for the demanded EUO and to produce the requested claim-related documents constituted a material breach of the policy's cooperation clause. The analysis then shifted to the prejudice component. Westchester argued it was prejudiced by McGraw's failure to appear for an EUO and produce requested documentation prior to filing suit because the "premature filing required Westchester to begin litigating this case before it was able to make a coverage determination and investigate the full facts surrounding Plaintiff's storm damages claim. It also prejudices Westchester in determining whether Plaintiff's attempt to invoke the appraisal process in this lawsuit has any merit." *McGraw Prop. Sols. LLC,* 2024 WL 1702680, at *4. The district court agreed, finding that "any reasonable jury would conclude that Westchester was substantially prejudiced in defending the present declaratory judgment and breach of contract action, where McGraw is seeking to compel appraisal and requesting damages for Westchester's failure to repair or replace all of the covered damages to the property." *Id.* It specifically noted that at the time of McGraw's filing, Westchester was still in the midst of its coverage investigation and had not yet made a coverage determination. *Id.*

Policyholder's Appraisal Demand Does Not Suspend Post Loss Duties Enumerated in Policy

The court then examined whether McGraw was excused from performing its post loss duties, such as sitting for an EUO, because, as McGraw contended, Westchester breached the policy first. Specifically, McGraw contended that Westchester breached the contract when it did not comply with McGraw's demand for an appraisal; consequently, McGraw was no longer required to abide by the Policy's post loss obligations for the insured. *Id.* at *5.

The district court noted that an insurance policy's appraisal clause is enforceable in a court of law, and a court may compel compliance with it. *Id.* (*citing Lundy v. Farmers Grp., Inc.*, 322 Ill. App. 3d 214, 218 (2d Dist. 2001)). It also noted that a material breach of a contract provision by one party may be grounds for releasing the other party from his contractual obligations." *Id.* (*citing Mohanty v. St. John Heart Clinic, S.C.*, 225 Ill. 2d 52, 70 (2006)). After determining that Illinois courts had not squarely addressed the issue of whether an insured's invocation of a policy's appraisal clause relieves that party of its contractual post loss duties if the insurer does not engage in appraisal first, the court turned to the decisions of those who had. *McGraw Prop. Sols. LLC,* 2024 WL 1702680, at *5. In its review of decisions from a number of other jurisdictions, the court concluded that an insured must fulfill its contractual post loss duties before it can seek appraisal. *Id.*

It placed heavy reliance on *United States Fidelity & Guaranty Co. v. Romay*, 744 So. 2d 467 (Fla. Dist. Ct. App. 1999). In *Romay*, just like *McGraw,* the insureds invoked appraisal prior to submitting a sworn proof of loss and sitting

for an EUO. The court in *Romay* held that it would be unreasonable for an insured to be able to compel appraisal without fulfilling its post loss obligations because:

> If that were so, a policyholder, after incurring a loss, could immediately invoke appraisal and secure a binding determination as to the amount of loss. That determination, in turn, could be enforced in the courts. Under that framework, expressed and agreed-upon terms of the contract, i.e., the post loss obligations, would be struck from the contract by way of judicial fiat and the bargained-for contractual terms would be rendered surplusage.

McGraw Prop. Sols. LLC, 2024 WL 1702680, at *6 (citing *Romay*, 744 So. 2d at 467).

The *McGraw* court agreed with this reasoning, holding that before a policyholder can seek appraisal, it is required to first comply with the policy's post loss duties, including submitting to an EUO and producing relevant records. *Id.* at *6. It specifically held that:

> It would be nonsensical to require an insurer to engage in appraisal while the insurer is still conducting its investigation and before the insured complied with its post loss obligations, since this would affect the insurer's ability to ascertain its estimate of the amount of loss. Despite Illinois courts not having ruled on this specific issue, this approach aligns with the emphasis Illinois courts have placed on an insured's duty to cooperate with insurers because of the information asymmetry between the insured and insurer about a claimed loss event.

Id. Based on the above, the *McGraw* court found that no reasonable jury would find that Westchester materially breached the policy by refusing to participate in the appraisal process while it was still investigating coverage. *Id*.

Conclusion

The decision in *McGraw* stands for the well-reasoned proposition that a policyholder cannot invoke the appraisal process while a carrier's coverage investigation remains ongoing. It also serves as a warning to those public adjusters and policyholder attorneys who seek to impede insurers' coverage investigations by lodging premature appraisal demands in an attempt to foreclose a carrier's ability to secure relevant documentation and EUO testimony from the insured. Illinois first-party coverage practitioners would be well-advised to bring this common-sense decision to the attention of their clients' claim departments so that full and complete coverage investigations can be carried out, even in the presence of bad faith or premature appraisal demands, such as those lodged in *McGraw*.

About the Author

James P. DuChateau is a partner in the Chicago office of *HeplerBroom LLC*, where he concentrates his practice in the areas of insurance coverage and commercial law in State and Federal Courts throughout the Midwest and Mountain West, including the investigation and litigation of first-party property claims, commercial general liability defense, prosecution of declaratory matters for non-coverage under personal and commercial policies and the defense of bad faith and extra contractual liability matters. Mr. DuChateau counsels both property and casualty carriers during the claim process, and

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