2016 WL 1321507
Only the Westlaw citation is currently available.
United States District Court,
D. Colorado.

Auto-Owners Insurance Company, a Michigan corporation, Plaintiff/Counter-Defendant,
v.
Summit Park Townhome Association, a Colorado corporation, Defendant/Counter-Plaintiff.

Civil Case No. 14-cv-03417-LTB
|
Signed 04/05/2016

100 FSupp 3d 1099

MEMORANDUM OPINION AND ORDER

Babcock, J.

*1 This insurance coverage dispute is before the Court on Plaintiff/Counter-Defendant Auto-Owners Insurance Company's ("Auto-Owners") Objection to George Keys Acting as Appraiser Based on Recently Discovered, Undisclosed Relationships with Defendant and Its Representatives [Doc. # 41]. I have reviewed the objection, the supplement thereto [Doc. # 55], Defendant/Counter-Plaintiff Summit Park Townhome Association's ("Summit Park") omnibus response [Doc. # 59], the reply [Doc. # 60], and the parties' notices of supplemental authority [Docs. # 63, 64, 66]. I have also considered the oral arguments presented at the hearing held on March 31, 2016.

Consistent with my ruling on the record at the hearing, I conclude that the undisputed material facts establish that Keys, who is Summit Park's appraiser, is not "impartial" as required by the insurance policy in this case. Summit Park's and Keys' failure to disclose material information regarding, among other things, Keys' extensive relationship with Summit Park's counsel, violated my order requiring disclosure of facts that a reasonable person would consider likely to affect an appraiser's impartiality. With Keys' involvement, the appraisal process yielded a "replacement cost value" of $10.87 million, which is $3.47 million—or 47%—greater than Summit Park's own adjuster calculated before this lawsuit was filed. For the reasons set forth herein, I **SUSTAIN** the objection, **DISQUALIFY** Keys from serving as an appraiser in this matter, and **VACATE** the appraisal award lodged with the Court on December 23, 2015.

I. Facts

A. Procedural History

This is a declaratory judgment action brought by Auto-Owners to determine the extent of coverage under a property insurance policy it issued to Summit Park for damage to buildings on Summit Park's premises from a 2013 hailstorm. At the outset of this case, Summit Park invoked the appraisal provision of the policy, under which "each party will select a competent and impartial appraiser," the court selects an umpire if the appraisers cannot agree on a selection, and a "decision agreed to by any two" of the three as to the "value of the property and amount of loss" "will be binding." Doc. # 6-1 at 78. The policy provides that Auto-Owners "will pay for covered loss or damage within 30 days after we receive the sworn proof of loss...if [a]n appraisal award has been made." *Id.* at 80.

In April 2015, I ordered the appraisal process to proceed. Doc. # 17. In September 2015, upon the parties' failure to reach agreement on various aspects of the process, I imposed several guidelines to govern the process and appointed an umpire, Robert J. Norton. Docs. # 25, 31. One of the guidelines I imposed stated:

> An individual who has a known, direct, and material interest in the outcome of the appraisal proceeding or a known, existing, and substantial relationship with a party may not serve as an appraiser. Each appraiser must, after making a reasonable inquiry, disclose to all parties and any other appraiser any known facts that a reasonable person would consider likely to affect his or her impartiality, including (a) a financial or personal interest in the outcome of the appraisal; and (b) a current or previous relationship with any of the parties (including their counsel or representatives) or with any of the participants in

agreement...for approximately four months," at which time the agreement was amended to remove the "not to exceed" language. Doc. # 55 at 10. Summit Park fixes the time from Keys' appointment to the execution of the amended agreement at "less than 90 days." Doc. # 59 at 48.

II. Analysis

A. Waiver

Summit Park argues that Auto-Owners waived any objections regarding the appraisal award by paying the award. Under Colorado law, which the parties agree applies here, an insurer may pay an insured under a reservation of rights and then seek to recoup its payment. *See Valley Forge Ins. Co. v. Health Care Mgmt. Partners, Ltd.*, 616 F.3d 1086, 1091-92 (10th Cir. 2010). An insurer may lose the right to contest coverage where it fails to make a reservation of rights. *See Management Specialists v. Northfield Ins. Co.*, 117 P.3d 32, 37 (Colo. App. 2004); *see also Nikolai v. Farmers Alliance Mut. Ins. Co.*, 830 P.2d 1070, 1073 (Colo. App. 1991).

As set forth above, Auto-Owners explicitly made a full reservation of rights when it paid the appraisal award and, accordingly, has not waived the right to seek recoupment of that payment. Summit Park cites cases in which the insurer made payment without having reserved its rights or took other actions that might have led the insured to believe the insurer was not contesting coverage. *See, e.g., Pueblo Country Club v. AXA Corp. Sols. Ins. Co.*, No. 05-cv-01296-WYD-MJW, 2007 WL 951790 (D. Colo. Mar. 28, 2007) (insurer failed to reserve rights until after payment of settlement to third party). No such circumstances exist here and, therefore, these authorities are inapplicable. In addition, the policy may reasonably be read to require Auto-Owners to pay an appraisal award within 30 days. *See* Doc. # 6-1 at 80 (providing that Auto-Owners "will pay for covered loss or damage within 30 days after we receive the sworn proof of loss...if [a]n appraisal award has been made"). Summit Park's waiver argument is therefore without merit.

B. Impartiality

The policy does not define the term "impartial." Neither the parties nor the Court have located any Colorado appellate authority construing the term in the context of an appraisal provision like the one here. Under Colorado law, "[w]ritten contracts that are complete and free from ambiguity will be found to express the intention of the parties and will be enforced according to their plain language." *Ad Two, Inc. v. City & Cty. of Denver ex rel. Manager of Aviation*, 9 P.3d 373, 376 (Colo. 2000). In the disclosure order, I found the definition of a "neutral arbitrator" set forth in the Colorado Uniform Arbitration Act, Colo. Rev. Stat. § 13-22-211, helpful in providing basic guidance to the parties. *See* Doc. # 25 at 12. I ruled that "[a]n individual who has a known, direct, and material interest in the outcome of the appraisal proceeding or a known, existing, and substantial relationship with a party may not serve as an appraiser." Doc. # 25. I did not indicate that this definition was all-encompassing with respect to impartiality.

Colorado case law regarding the neutrality required of arbitrators provides additional guidance. An arbitrator must "exercise a high degree of impartiality, without the slightest degree of friendship or favor toward either party." *Noffsinger v. Thompson*, 54 P.2d 683, 683 (Colo. 1936). And "[e]vident partiality has been found when a reasonable person would have to conclude that an arbitrator would be predisposed to favor one party to the arbitration." *McNaughton & Rodgers v. Besser*, 932 P.2d 819, 822 (Colo. App. 1996). In this regard, a "pecuniary interest" or the "existence of an adversarial or sympathetic relationship" between an arbitrator and a party's counsel are "[f]acts indicating [an arbitrator's] bias." *See id.*; *see also* 15 Couch on Ins. § 211:33 (section on "Arbitrators, Appraisers and Proceedings Before Them" providing that "[d]isinterest in the matter does not mean merely a lack of pecuniary interest, but is used in a broader sense, as impartial, fair, open-minded, and without partisanship, prejudice, or bias").

*5 Based on these authorities, Keys cannot be considered impartial. His relationship with Merlin goes well beyond the mere "retention of an expert on multiple engagements" that I suggested would be permissible in the disclosure order. Doc. # 25 at 11. In addition to working on dozens of prior cases in which Keys was retained by the policyholder, Merlin and/or Merlin attorneys have served as Keys' personal counsel, served as incorporator and registered agent for Keys' companies, taught with Keys, and donated to a Keys-led group involved in pro-policyholder lobbying. These aspects of the relationship between Keys and Merlin, viewed collectively, make clear that he cannot satisfy any of the standards of impartiality set forth above, whether framed in terms of "a known, existing, and substantial relationship with a party," "friendship or favor" towards a party, a "sympathetic relationship" towards a party, "partisanship," or a "predispos[ition] to favor one party."

I am not the first judge to disqualify Keys from serving as an appraiser on this basis; a state court judge recently did so in a case in which Keys and lawyers at another law firm, the Childress Duffy firm, were both working for the policyholder. *See Axis Surplus Ins. Co. v. CityCenter West LP*, No. 2015 CV 30453 (Colo. Dist. Ct. Weld Cnty. Mar. 14, 2016) [Doc. # 63-1]. The court noted that Keys' relationship with lawyers at the firm was sufficient to disqualify him from serving as an impartial appraiser "based only on past involvement in cases in which those lawyers were representing one of the parties." *Id.* at 2. The court held that the fact that Keys had formed a business partnership with some of the lawyers, "advocated in support of positions taken by" them, and "socialized with them" only compounded the problem. *Id.*

While Keys' relationship with Merlin is sufficient by itself to render him other than impartial, the totality of the circumstances here make this conclusion unavoidable. As noted above, Keys has made numerous comments suggesting a bias in favor of policyholders. The initial fee agreement under which Keys was initially retained in this case—which capped his fees and expenses at 10% of Summit Park's recovery—raises further concerns. Judge Jackson of this Court recently vacated an appraisal award made by an appraiser whose fee was capped at "5% of the replacement cost value of the final claims if an umpire is involved." *Colorado Hosp. Servs. Inc. v. Owners Ins. Co.*, No. 14-CV-001859-RBJ, 2015 WL 4245821, at *2 (D. Colo. July 14, 2015). He noted that because "the higher his appraisal, the higher the cap on his fee," the appraiser "cannot be considered to be 'impartial' under any reasonable definition of that term." *Id.* Judge Jackson rejected the argument that because the appraiser's appraisal "was prepared before the umpire was selected and while he was still on an hourly fee," the "motive to reach a higher appraisal" was eliminated. *Id.* at *3.

Here, Summit Park points out that the initial agreement with Keys was amended in July 2015—about three months after Keys' appointment as an appraiser and "well before any substantive work with the appraisal panel occurred"—to remove the contingent cap on his compensation. Doc. # 59 at 49. Notably, however, Summit Park does not deny that Keys performed at least some work while the initial agreement was in place. Summit Park argues that the contingent cap was merely intended to "limit the amounts that would be charged to the policyholder in the event that the appraisal panel determined that only a limited amount was owed," rather than incentivize a higher appraisal award. *Id.* at 48. But this argument only highlights the problem: an appraiser operating under such an agreement has a motive to ensure that the appraisal panel *does not* "determine [ ] that only a limited amount was owed," in Summit Park's words, but, rather, determines that a *greater amount* was owed. The fact that Keys was operating under the agreement, even for a short period, is enough, by itself, to render him other than impartial. I note that, before this lawsuit was filed, Summit Park's public adjuster estimated a replacement cost value of $7,140,117.82 for the damaged buildings, including replacement of undamaged vinyl siding to achieve matching. *See* 2d Am. Compl. ¶ 28 [Doc. # 6]. The corresponding figure in the appraisal award in which Keys participated, by contrast, is $10,870,090.96, an increase of $3.47 million, or 47%. Doc. # 35. Such a dramatic increase, coinciding with Keys' involvement in this case, confirms my doubts regarding his impartiality.

*6 Despite the foregoing, the extent of Summit Park's disclosure to Auto-Owners regarding Keys was that Keys "has acted as a public adjuster and/or appraiser on behalf of policyholders that the Merlin Law Group has represented in the past"; neither Summit Park nor Merlin made any effort to disclose the number of times Merlin attorneys had worked together or the other aspects of their relationship outlined above. Doc. # 60-7. Keys' similar disclosure that he and Merlin had previously "acted for the same insured" was similarly lacking. Doc. # 60-12. And his representation that he did "not have any substantial business relationship...[with] Merlin Law Group" was, at best, misleading. Doc. # 60-12. In addition, Keys' original fee agreement was not disclosed until December 2015. As the court in *Axis Surplus* noted in disqualifying Keys, "[w]hat is even more troubling is that Keys chose not to disclose this information" because, "[e]ven if Keys believed he had no legal obligation to [do so], he had to know that this information would cause [the insurer] concerns." *Axis Surplus, supra*, at 2. "Instead of being aboveboard and demonstrating his neutrality, [Keys'] nondisclosure only raises suspicions about his impartiality and creates the appearance that he was trying to hide" the damaging information. *Id.* at 2-3. These comments ring equally true here.

While it is disappointing that—as Summit Park points out—Auto-Owners failed to seek relief from the Court when it received the insufficient disclosures from Merlin and Keys (in June 2015 and November 2015, respectively), this does not absolve Merlin or Keys from responsibility. The disclosure order imposed on each appraiser a duty to disclose "known facts that a reasonable person would consider likely to affect his or her impartiality," including "a current or previous relationship with any of the parties (including their counsel or representatives)." Doc. # 25 at 12-13. And the order required "[t]he parties and their counsel [to] make every reasonable effort to ensure that the appraisal