SUPREME COURT OF FLORIDA

CASE NO. 77,286

AMERICAN HOME ASSURANCE COMPANY

Petitioner,

v.

LARKIN GENERAL HOSPITAL, LTD., etc.

Respondent.

ON DISCRETIONARY REVIEW UPON CERTIFIED CONFLICT
FROM THE DISTRICT COURT OF APPEAL, THIRD DISTRICT

PETITIONER'S REPLY BRIEF

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TABLE OF CONTENTS

	PAGE
TABLE OF CITATIONS	iii
SUMMARY OF ARGUMENT ON REPLY	1
ARGUMENT	2
I. AMERICAN RELIES UPON ITS INITIAL BRIEF ON THE MERITS WITH RESPECT TO THE CERTIFIED CONFLICT ISSUE, SINCE LARKIN BARELY ADDRESSED THE CERTIFIED CONFLICT ISSUE IN ITS ANSWER BRIEF.	2
II. THE ARBITRATION AWARD AGAINST CONTRACTOR DOES NOT CONCLUSIVELY DETERMINE SURETY'S LIABILITY, SINCE THE COVERAGE ISSUE WAS NOT ADDRESSED IN THE ARBITRATION.	3
A. Coverage Issues Are For The Courts To Decide.	4
B. An Arbitration Award Is Only Conclusive Against the Surety As To Those Issues Determined In The Arbitration Proceeding.	5
III. AMERICAN'S COVERAGE DEFENSE RENDERS INAPPLICABLE THE MAXIM OF "COEXTENSIVE" LIABILITY WITH THE PRINCIPAL.	8
IV. LARKIN'S "ISSUE II" IS IRRELEVANT TO THE CERTIFIED CONFLICT ISSUE.	9
A. Collateral Estoppel Does Not Apply To The Performance Bond Coverage Issue.	9
B. LARKIN Did Not Obtain An Arbitration Award Against AMERICAN; Trial Court Proceedings Were Not Stayed.	10
C. The Trial Court Permitted AMERICAN To Raise The Performance Bond Coverage Issue, And LARKIN Has Not Appealed That Ruling.	10

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D. Difficulty Of Proof Or Adjudication Of Damages Covered By The Performance Bond Is Not Justification For Imposing Liability Against The Surety For All Damages Sustained, Including Those Not Covered By The Bond. 11

CONCLUSION 12

CERTIFICATE OF SERVICE 13

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TABLE OF AUTHORITIES

CASES	PAGE(S)
American Fidelity Fire Insurance Co. v. Richardson, 189 So.2d 486 (Fla. 3d DCA 1966)	4, 5
Bruno v. Travellers Insurance Company, 386 So.2d 251 (Fla. 3d DCA 1980)	4-5
Cone v. Benjamin, 8 So.2d 476 (Fla. 1942)	8
Criterion Insurance Co. v. Amador, 479 So.2d 300 (Fla. 3d DCA 1985)	4
Deeb, Inc. v. Board of Public Instruction of Columbia County, 208 So.2d 460 (Fla. 1st DCA 1968)	6
Fidelity and Deposit Company of Maryland v. Parson & Whittemore Contractors Corp., 397 N.E.2d 380 (N.Y. 1979)	6
Lake County v. Massachusetts Bonding and Insurance Co. 75 F.2d 6 (5th Cir. 1935)	5
MacArthur v. Gaines, 286 So.2d 608 (Fla. 3d DCA 1973)	5, 7
McDonald v. Allstate Insurance Company, 408 So.2d 580, 582 (Fla. 4th DCA 1981)	4
Mobile Oil Corp. v. Sevlin, 354 So.2d 372 (Fla. 1977)	10
Nationwide Insurance Co. v. Cooperstock, 472 So.2d 547 (Fla. 4th DCA 1985)	4
United States Fidelity and Guaranty Company v. Gulf Florida Development Company, 365 So.2d 498 (Fla. 1st DCA 1978)	2

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United States Fidelty and Guaranty Co. v. Woolard, 523 So.2d 798, 799 (Fla. 1st DCA 1988) 4

Vigilant Insurance Co. v. Kelps, 372 So.2d 207 (Fla. 3d DCA 1979) 4

Von Engineering Company v. K.W. Roberts Construction Co., Inc., 457 So.2d 1080 (Fla. 5th DCA 1984) 5, 7

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SUMMARY OF ARGUMENT ON REPLY

LARKIN's answer brief only marginally addressed the issue that is the subject of the appellate court's certification of conflict: whether the performance bond obligation of the surety includes consequential delay damages sustained by the owner due to the contractor's default. LARKIN's position is not compelling. This Court's ruling on the certified conflict issue will be determinative on the dispute between LARKIN and AMERICAN. The remainder of LARKIN's brief concerns collateral matters which, while contested by the parties below, are not controlling.

Even on the collateral topics, LARKIN errs by failing to recognize that an owner's arbitration proceeding against a contractor is not conclusive against the surety regarding performance bond coverage issues. Coverage issues are for the courts to decide. Issues that were not within the scope of the arbitration proceeding are not, and by reason cannot be, conclusively established for subsequent proceedings.

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ARGUMENT

I. AMERICAN RELIES UPON ITS INITIAL BRIEF ON THE MERITS WITH RESPECT TO THE CERTIFIED CONFLICT ISSUE, SINCE LARKIN BARELY ADDRESSED THE CERTIFIED CONFLICT ISSUE IN ITS ANSWER BRIEF.

The issue on certified conflict, as recognized by the Third District Court of Appeal, is whether the performance bond surety provides coverage under its bond for delay damages sustained by the owner as a result of the contractor's default. In its Answer Brief, LARKIN devotes a single page to this issue (p.14), with the remainder of its Answer Brief going off on tangents.

LARKIN's argument on the certified conflict issue is limited to a recitation of the previous Fourth District Court of Appeal ruling on the issue. LARKIN fails to develop a compelling rationale for abandoning the First District Court of Appeal's decision in **United States Fidelity and Guaranty Company v. Gulf Florida Development Company**, 365 So.2d 498 (Fla. 1st DCA 1978) as the appropriate rule regarding the surety's coverage under its performance bond, i.e., that the bond does not provide coverage for delay damages.

LARKIN does not dispute the purpose of the performance bond: to insure that the owner does not sustain out-of-pocket expenses for the completion of the project upon the contractor's default. LARKIN does not contest that the surety's entitlement to limiting coverage to its contractual undertaking under the bond. Finally, LARKIN does not dispute that the issue of bond coverage for delay

damages was not determined in the arbitration proceedings, and that the arbitration award included substantial delay damages.

LARKIN does not contest these major points addressed in AMERICAN's Initial Brief on the Merits. Accordingly, AMERICAN will rely on its Initial Brief on the Merits with respect the issue on certified conflict between the districts. The remainder of this Reply Brief will address the various collateral issues set forth in LARKIN's Answer Brief.

II. THE ARBITRATION AWARD AGAINST CONTRACTOR DOES NOT CONCLUSIVELY DETERMINE SURETY'S LIABILITY, SINCE THE COVERAGE ISSUE WAS NOT ADDRESSED IN THE ARBITRATION.

The Award of the Arbitrators rendered in the proceedings between LARKIN and Contractor is not conclusive against AMERICAN on the performance bond coverage issue. AMERICAN's coverage defense, arising under the terms and conditions of its bond, was not an issue in the arbitration proceedings between LARKIN and Contractor. LARKIN does not dispute that the coverage issue raised by AMERICAN in the trial court was not submitted to the arbitration panel for consideration.

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A. Coverage Issues Are For The Courts To Decide.

It is well recognized in Florida that coverage issues are to be determined by a court, not by arbitrators. **United States Fidelity and Guarantee Co. v. Woolard**, 523 So.2d 798, 799 (Fla. 1st DCA 1988) ; **Criterion Insurance Co. v. Amador**, 479 So.2d 300 (Fla. 3d DCA 1985); **Nationwide Insurance Co. v. Cooperstock**, 472 So.2d 547 (Fla. 4th DCA 1985) ; **McDonald v. Allstate Insurance Company**, 408 So.2d 580, 582 (Fla. 4th DCA 1981); **Bruno v. Travellers Insurance Company**, 386 So.2d 251 (Fla. 3d DCA 1980); **Vigilant Insurance Co. v. Kelps**, 372 So.2d 207 (Fla. 3d DCA 1979); **American Fidelity Fire Insurance Co. v. Richardson,** 189 So.2d 486 (Fla. 3d DCA 1966).[1/] In sharp contrast to the foregoing line of cases, LARKIN implies that AMERICAN was not entitled to raise a coverage issue as a defense outside of the LARKIN - Contractor arbitration forum. LARKIN's contention has no merit under Florida common law.

In **Bruno v. Travellers Insurance Company, supra,** 386 So.2d 251 (Fla. 3d DCA 1980), plaintiffs had filed a petition for confirmation of an award against an arbitration participant insurance company. The court rejected confirmation of the arbitration award where there were unresolved coverage issues, ruling that those issues were for the court to determine:

> [T]he issues now raised by [the insurance company] are not ones which inhere in the

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[1/]Many of these cases are already cited and quoted in AMERICAN's Initial Brief on the Merits, pp. 21-22, including fn.10.

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> award itself. Rather, they concern the contention that, by virtue of extrinsic facts and the terms of its policy and the Florida law, the company is not contractually or statutorily obliged to pay the award. These are questions which only the courts, and not the arbitrators, have the authority to resolve.

386 So.2d at 253 (and citing, with favor, **Richardson, supra**).

Coverage issues are for the courts to decide. The arbitration award against Contractor was not inherently binding on AMERICAN where the coverage issue was unresolved.

B. An Arbitration Award Is Only Conclusive Against the Surety As To Those Issues Determined In The Arbitration Proceeding.

In Florida, the general rule is that where a surety has notice of an arbitration proceeding against the principal and is afforded an opportunity to appear and defend, an award is conclusive against the surety **as to all material issues therein determined**, so long as no fraud or collusion is involved in the award. **Von Engineering Company v. R.W. Roberts Construction Co., Inc.**, 457 So.2d 1080 (Fla. 5th DCA 1984) (applying indemnity law; emphasis added); **MacArthur v. Gaines**, 286 So.2d 608 (Fla. 3d DCA 1973) (same). The **Von Engineering** rule applies solely "as to all material questions therein determined [in the arbitration proceeding]." 457 So.2d, at 1082.[2/]

[2/] Citing **MacArthur v. Gaines, supra** and **Lake County v. Massachusetts Bonding and Insurance Co.** 75 F.2d 6 (5th Cir. 1935).

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Arbitration proceedings are binding only as to the matters submitted to arbitrators; any matters not within the scope of the arbitration are not legally settled by the arbitration award. **Deeb, Inc. v. Board of Public Instruction of Columbia County**, 208 So.2d 460 (Fla. 1st DCA 1968). Thus, the surety's coverage defense on a performance bond survives an arbitration proceeding between an owner and contractor on the construction contract.

The sound logic supporting the rule that arbitration proceedings are binding against the surety only on those matters concerning the construction contract agreement, and not those arising out of the performance bond, are most clearly set out in **Fidelity and Deposit Co. of Maryland v. Parson & Whittemore Contractors Corp.**, 397 N.E.2d 380 (N.Y. 1979).[3/] In its well-reasoned decision, the highest court in New York squarely addressed this point, stating:

> By incorporation in its performance bond of a subcontract containing a broad arbitration clause, the surety company agreed that disputes arising under the subcontract between the general contractor [obligee] and the subcontractor [principal] would be submitted to arbitration and that it would be bound by the determination made in such arbitration. . . . [The surety company] did not agree, however, that separate and distinct controversies, if any, which might arise under the terms of the performance bond between the general contractor as obligee thereunder and the surety company would be submitted to arbitration. . . .
>
> . . . A critical distinction must be drawn between disputes arising under the subcontract

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3/ A copy of this case was included in the appendix to the brief filed with the Third District Court of Appeal.

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> . . . and possible unrelated differences which may arise between [the surety] and [the obligee] as to the liability of the surety company under the terms of its performance bond. . . .
>
> . . . [T]here was no agreement on the part of any party that controversies arising as to rights and obligations under the terms of the performance bond would be submitted to arbitration. . . .
>
> . . . Certainly there is no language in the performance bond on which to base any argument that it was obligated to submit disputes arising under its performance bond (as distinguished from disputes arising under the subcontract) to resolution by arbitration.

397 N.E.2d at 381-382.

LARKIN contends that "[a] judgment against a principal is conclusive against a surety even through the surety did not participate in the earlier proceeding." (LARKIN's Answer Brief, p.11.) This proposition is not a correct statement of Florida law. The prior proceeding is **only** binding on the surety **as to issues addressed and determined** in that proceeding. **Von Engineering Company v. K.W. Roberts Construction Co., Inc.**, 457 So.2d 1080 (Fla. 5th DCA 1984); **MacArthur v. Gaines**, 286 So.2d 608 (Fla. 3d DCA 1973).

III. AMERICAN'S COVERAGE DEFENSE RENDERS INAPPLICABLE THE MAXIM OF "COEXTENSIVE" LIABILITY WITH THE PRINCIPAL.

LARKIN argues that the surety's liability is the same as that of the contractor. LARKIN's position does not permit the surety to raise personal defenses. LARKIN in essence argues, "Surety, your defenses are only those that are raised by the contractor." This argument is patently false.

While Florida courts have recognized the maxim that a surety's liability is "co-extensive" with that of its principal, this adage is not a license to expand the surety's liability beyond the terms of its bond. It is essentially a limitation of the surety's liability to no greater than that of its principal. Where the surety has a viable defense that is not available to the principal, the liability of the two parties will not be "co-extensive". The expression must be considered in context; it is only appropriate where the defenses of surety and principal are identical.

Florida's courts have consistently limited a surety's ultimate liability to the express terms of the bond. For example, the Florida Supreme Court in **Cone v. Benjamin**, 8 So.2d 476 (Fla. 1942), held that a surety's liability is co-extensive with that of its principal **"within the terms of the contract of suretyship." Id.** (emphasis provided). LARKIN would prefer to ignore the phrase "within the terms of the contract of suretyship," and instead create a world where the surety does not have any defenses other than those of the contractor. LARKIN's position unjustifiably expands the surety's obligations beyond those set forth in the bond.

Contrary to LARKIN's argument, the surety has defenses under its bond that are not available to the contractor. The surety is entitled to rely on basic contract principles that its liability will not extend to matters beyond the performance bond's terms, regardless of the contractor's liability.

IV. LARKIN'S "ISSUE II" IS IRRELEVANT TO THE CERTIFIED CONFLICT ISSUE.

A. Collateral Estoppel Does Not Apply To The Performance Bond Coverage Issue.

LARKIN's "Issue II" is a non-issue.[4/] AMERICAN is not asking the court to allow a new trial on the issues of Contractor's "performance, default, and notice". However, the performance bond coverage issue was not litigated in the arbitration proceeding between LARKIN and Contractor.

LARKIN argues that collateral estoppel prevents AMERICAN from "re-litigating" the surety defense issues. However, AMERICAN was not a party to the arbitration. Its coverage defense was litigated **for the first time** in the trial court. Since the coverage issue was not an issue in the LARKIN -Contractor arbitration proceedings, collateral estoppel is not a bar to consideration of the issue in the trial court. The prerequisites recited by LARKIN for

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[4/]The issue debated at length by LARKIN in its "Issue II", concerning the prejudice to surety due to LARKIN's decision to wait for eighteen months before notifying AMERICAN of Contractor's default, is not the subject of review before this Court. See AMERICAN's Initial Brief on the Merits, page 5, fn.4. However, the surety's prejudice defense was another issue not determined in the LARKIN - Contractor arbitration proceeding.

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collateral estoppel, identity of the parties and of the issues, are absent. Therefore, collateral estoppel does not apply. **Mobile Oil Corp. v. Sevlin**, 354 So.2d 372 (Fla.1977).

B. LARKIN Did Not Obtain An Arbitration Award Against AMERICAN; Trial Court Proceedings Were Not Stayed.

Once again, LARKIN attempts to lead the Court astray by asserting that "[a]fter suffering an adverse Arbitration Award, ... AMERICAN sought leave of court" to raise its personal defenses. LARKIN's Answer Brief, at 18. The arbitration award was not against AMERICAN; LARKIN chooses to ignore this fact.

Also, LARKIN claims that AMERICAN obtained a stay of the LARKIN - AMERICAN circuit court proceedings. But the record on appeal clearly reflects that there was no stay hearing and that no stay order was entered.

C. The Trial Court Permitted AMERICAN To Raise the Performance Bond Coverage Issue, And LARKIN Has Not Appealed That Ruling.

Like the ostrich, LARKIN blinds itself to the fact that the trial court permitted AMERICAN to raise the coverage issue in the LARKIN - AMERICAN court proceeding. R.I-48. In essence, LARKIN contends that the trial court's order allowing AMERICAN to raise the coverage issue, after the LARKIN - Contractor arbitration had concluded, was somehow error. However, the purported error is never clearly defined by LARKIN. Moreover, the argument is improper because LARKIN has not cross-appealed the trial court's order

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permitting AMERICAN to raise the coverage issue in affirmative defenses and in the counterclaim.

D. Difficulty Of Proof Or Adjudication Of Damages Covered By The Performance Bond Is Not Justification For Imposing Liability Against The Surety For All Damages Sustained, Including Those Not Covered By The Bond.

Finally, LARKIN makes the untenable argument that, even if AMERICAN's performance bond did not provide coverage for the contractor-caused delay damages, the Court nonetheless should hold AMERICAN liable for those damages because the trial court may have difficulty determining (or LARKIN may have difficulty proving) LARKIN's completion cost damages.[5/] The degree of difficulty that may or may not be encountered either by LARKIN in proving its completion cost damages or by the trial court in determining those damages is totally irrelevant to the issue of AMERICAN's liability under its performance bond. The courts must apply and enforce the laws of the state, and cannot wash their hands of this obligation for the sake of convenience.

The remainder of LARKIN's arguments in "Issue II" likewise are non-meritorious and have no bearing on the certified conflict issue before this Court.

[5/]In the LARKIN - Contractor arbitration proceedings, LARKIN claimed entitlement to $201,945.76 in completion costs. R.II-161; Tr.Exh. F. The remainder of LARKIN's claim was for consequential delay damages. **Id.**

CONCLUSION

AMERICAN is entitled to enforce the terms of its undertaking. AMERICAN had no duty under the bond to pay delay damages. Thus, AMERICAN's bond coverage does not include liability for the entire arbitration award, which includes delay damages.

For the foregoing reasons, AMERICAN asks that the final judgment in favor of LARKIN be reversed, that the application to confirm the arbitration award against AMERICAN be denied, and the case be remanded to the trial court for determination of the amount of LARKIN's damages covered under the performance bond.

Respectfully submitted,

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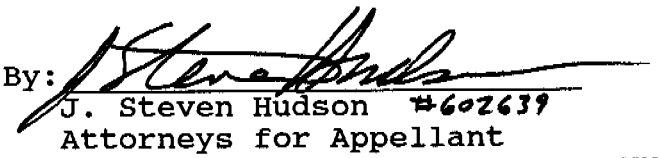
By: 
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CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing Reply Brief was served by U.S. Mail this 11th day of April, 1991, to JAMES E. GLASS, ESQ., James E. Glass Associates, Attorney for Plaintiff/Appellee, 616 Blue Lagoon Drive, Suite 350, Miami, Florida 33126.

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