ORIGINAL

IN THE SUPREME COURT OF FLORIDA

CYNTHIA L. NICHOLS, as guardian of the property of BRITTANY ANN BOSS and MORGAN NICOLE BOSS, minors,

Petitioner,

vs.

CASE NO. 89,591

PREFERRED NATIONAL INSURANCE COMPANY,

Respondent.

ANSWER BRIEF OF RESPONDENT

ON APPEAL FROM THE
DISTRICT COURT OF APPEAL
FOR THE FIRST DISTRICT
STATE OF FLORIDA
CASE NO. 95-04140

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TABLE OF CONTENTS

TABLE OF CITATIONS

CASES

STATUTORY PROVISIONS

REFERENCES

PRELIMINARY STATEMENT

In this brief, the Defendant/Respondent, Preferred National Insurance Company adopts and utilizes the references from Petitioner's Preliminary Statement. The Circuit Court for the Fourth Judicial Circuit where this case was originally filed will be refered to as the "Trial Court". The Circuit Court for the Fourth Judicial Circuit where the guardianship proceedings took place will be referred to as the "Probate Court". References to documents within Respondent's Appendix will be to the lettered tab number under which the document appears with the page number contained on that document, as follows: "App.A.__". The Initial Brief of Petitioner will be referred to herein as "Initial Brief, p.__."

RESPONDENT' STATEMENT OF THE CASE AND STATEMENT OF FACTS

Respondent adopts Petitioner's Statement of the Case and Statement of Facts except as noted below:

Following Nichols appointment as successor guardian of the Minors on February 9, 1994, she mailed a letter dated March 21, 1994 to Preferred's agent making demand for the full penal sum of the Bond (i.e., $66,000.00). (R-2,7 & 44)(App. B) This was the first time Preferred was notified of Mr. Boss' potential breach of his duties as guardian principal on the Bond because Preferred was not a party to the underlying guardianship proceeding. (R.7) When Preferred questioned the Nichols' unsupported claim, she filed her Complaint against Preferred seeking recovery against Preferred under the Bond because Mr. Boss "failed to perform faithfully his duties as guardian according to the law." (R.1 & 2) (App. A) Specifically, she alleged that Mr. Boss, in his capacity as guardian, misappropriated $64,023.45 of the monies entrusted to him as guardian of his children, the Minors. (R.2) The Complaint sought recovery against Preferred under the Bond for Mr. Boss' breach of his statutory duties as guardian and for the breach of his obligations under the Bond to "perform faithfully his duties." (R.2) The Complaint did not allege that Preferred breached the terms of its Bond and did not assert any claim of bad

faith against Preferred. Nichols merely alleged that Preferred "failed and refused after repeated demands to make payment." (R. 2)

During the course of the litigation, Nichols served Plaintiff's First Request for Admissions to Defendant ("Request for Admissions") on January 10, 1995. (R. 24-44). On February 13, 1995, Preferred admitted to the majority of Plaintiff's assertions and to the authenticity of documents attached to Nichols' Request for Admissions in its response to the same. (R.4546). The documents attached to the Request for Admission documented for the first time Mr. Boss' misappropriation of the Minors' funds. (R. 24-44). Nichols served her Motion for Summary Judgment on March 3, 1995. (R. 53-57) (App.C). The Motion for Summary Judgment stated in paragraph 6, "The failure of [Mr. Boss] to faithfully perform all duties according to law as guardian of [the Minors], caused the obligations under the surety bond to become due," (R.55). Preferred did not file an affidavit in opposition to Nichols' Motion for Summary Judgment in light of the proofs provided in support of the Motion for Summary Judgment.

The Trial Court entered Summary Final Judgment on April 5, 1995, which contained no findings of fact other than the statement "it appearing to the Court that said Motion [for Summary Judgment] should be granted." (R.62-63) (App. D). In the Trial Court's Summary Final Judgment, it awarded the principal amount sought by

Nichols (i.e., $63,229.20), and prejudgement interest from March 21, 1994 (the date of Nichols' first demand letter to Preferred's agent) through the date of the judgment. (R.62-63). The Trial Court retained jurisdiction "for the purpose of assessing costs and attorneys' fees, if appropriate." (R.62-63). Before Preferred's 30 day appeal period had run, Nichols served a Writ of Garnishment on Preferred's operating account, and by agreement of the parties, $70,999.91 was released to Nichols without Preferred appealing the Summary Final Judgment. (R-64-69)

Nichols served her Motion for Award of Attorney's Fees on June 26, 1995, asserting that she was entitled to attorneys fees against Preferred under § 627.428, Fla. Stat. because Preferred, as a surety, was an "insurer" as defined by § 624.03, Fla. Stat. (R.77). Preferred opposed Nichol's Motion for Attorney's Fees on the grounds that the attorney's fees provision of § 627.428, Fla. Stat. did not apply to a surety unless the Florida Legislature specifically mandated its application to particular statutory bonds and that the liability of Preferred, as surety, for attorney's fees (if § 627.428, Fla. Stat. was found to apply) can not exceed the penal sum of the Bond. (R.lOl-107).

SUMMARY OF ARGUMENT

Nichols attempts to recast her Complaint as a "bad faith" cause of action against Preferred, claiming that the issue in this case is Preferred's "misconduct in delaying payment under the Bond." Nichols erroneously asserts that Preferred's liability arose and was fixed by the prior Probate Court's Order Removing Guardian. However, that Order did not make a factual determination that Mr. Boss misappropriated his children's assets. Further, Preferred was not a party to that action and had no notice or opportunity to assert available defenses and therefore was not bound by the Order Removing Guardian with regard to its obligations under the Bond. As set forth in Nichols' Complaint (R. 1-7), Preferred was sued under the Bond as a result of it's principal's alleged breach of his duties and responsibilities as a guardian, not bad faith on Preferred's part, Under the express terms of Preferred's Bond (R.5), Preferred's liability arises only if its principal fails to faithfully perform his duties as a guardian according to law. The fact remains that Nichols sued Preferred based on the actions of Preferred's principal, not based on Preferred's actions in asserting its right to defend against and require substantiation of Nichols' claim against the Bond before payment.

Florida case law is clear that a surety's liability for damages (including attorney's fees) cannot exceed the penal sum of its bond. Nichols' attempt to

distinguish clear authority relies on her unasserted "bad faith" claim against Preferred which she now belatedly tries to find in her Complaint. Nichols concedes that the present state of Florida law limits liability to the penal sum of the bond unless the bond or statute extend liability beyoond the penal sum. However, she argues that this rule of law should not apply due to Preferred's alleged "misconduct."

Nichols' anology of insurance policy cases to the present appeal is flawed. Her argument focuses on "bad faith" claims asserted against insurnace companies, a claim not asserted here. Further, her argument requires that this Court treat a surety and its obligations and an insurance company and its obligations as identical, even though said obligations are fundamentally different. For all these reasons the First District Court of Appeal's decision should be affirmed and the certified question answered affirmatively, with the limitation that attorney's fees and costs shall not cause the total damages and costs to exceed the penal sum of the Bond.

ARGUMENT

I. PREFERRED'S LIABILITY TO NICHOLS ARISES ONLY WHEN ITS PRINCIPAL UNDER THE BOND IS PROVEN TO HAVE BREACHED THE TERMS OF THE BOND, NOT WHEN NICHOLS MADE HER UNSUBSTANTIATED DEMAND FOR THE PENAL SUM OF THE BOND UPON PREFERRED.

Petitioner's Initial Brief (as did her Answer Brief in the prior appeal), at great length, attempts to recast Nichols' cause of action as alleged in her Complaint as a "bad faith" action against Preferred for failure to pay her the penal sum of the Bond following her unsubstantiated demand upon Preferred based upon the Probate Court's Order Removing Guardian. (R. l-7) (App. A.7). Nichols claims that, "The issue in this case is the surety's misconduct in delaying payment under the Bond, not the misconduct of the principal." (Initial Brief, p.10) However, Nichols never pleaded nor alleged "bad faith" or "misconduct" against Preferred in her Complaint, only liability under the Bond for Mr. Boss' breach of his abiligations.

The sole basis for Preferred's alleged misconduct is that it failed to immediately pay over to Nichols the penal sum of the Bond following her March 21, 1994 demand which enclosed a copy of the Order Removing Guardian entered by the Probate Court removing Mr. Boss as guardian. (R.7) (App. A.7 & B) Said order however did not make a factual determination that Mr. Boss misappropriated guardianship assets, but rather that he "may have depleted the guardianship assets

without court approval." (emphasis added) (R. 7) Nichols, however, takes the position that her mere demand upon Preferred to pay the penal sum of the Bond became a "valid claim under the Bond" (Initial Brief, p. IO), which forever barred Preferred from asserting any defenses of its own or those of its principal against her demand. In essence, Nichols treats her March 21, 1994 demand upon Preferred for the penal sum of the Bond as a "summary judgment" on the issue of its principal's liability for the guardianship assets, rather than a demand upon a surety to step into the shoes of its principal if it is proven that its principal failed to abide by the terms of the Bond.

In *Heritage Insurance Company of America v. Foster Electric Co., 393* So.2d 28 (Fla. 3rd DCA 1981), the court held that the legal effect on a surety of a judgment against its principal was that it constituted prima facia evidence that the surety is liable and the issue of liability may not then be contradicted by the surety. *Id.* at 29. However, the *court* in *Heritage* acknowledged that this prima facia rule is only applicable when "the surety knew of and had opportunity to defend the suit,,.." *Id.* at 29. Similarly, the *court* in *Dealers Insurance Co. v. Haid Co. Investment Enterprises,* 638 So.2d 127 (Fla. 3d DCA 1994) held that a judgment entered against a principal on a statutory automobile dealer's bond cannot conclusively establish liability as to the surety, where the surety had no opportunity to assert defenses.

There is no evidence in the appellate record which demonstrates or even suggests that Preferred had any knowledge of the underlying Order Removing Guardian entered on February 9, 1994 or an opportunity to raise defenses available at that time. In fact, Preferred had no opportunity to assert its defenses or potential defenses of its principal in that underlying guardianship action. Yet, Nichols relies solely upon the entry of the Order Removing Guardian to establish that Preferred's liability under its Bond "became fixed with respect to the actions of its principal" once it received notification of the Probate Court's order from her. (Initial Brief, p. 10) Such a position is contrary to Florida law and deprives Preferred of any due process in establishing its own liability under the Bond and asserting valid defenses on its behalf and on behalf of its principal. As the court succinctly stated in *MacArthur v. Gaines,* 286 So.2d 608 (Fla. 3d DCA 1973):

> It is well established that when an indemnitor has notice of suit against his indemnitee, and is afforded an opportunity to appear and defend, a judgment therein rendered against the indemnitee, if without fraud or collusion, is conclusive against the indemnitor as to all material questions therein determined.

Id. at 610.

The reverse of this holding is true as well: Where an indemnitor (i.e., in this case a surety) is not afforded an opportunity to appear and defend, a judgment (or the preclusive effect of the prior adjudication of the Probate Court as here) against the

indemnitee (i.e., the principal) is not conclusive against the indemnitor as to all material questions decided by the judgment or order. As a result, Preferred "liability" did not become "fixed" with regard to paying Nichols the penal sum of its Bond based upon Nichols' mere demand made on March 21, 1994 which made reference to the Order Removing Guardian. (App. A.7 & B)

Additionally, Nichols' Complaint sought only to collect against Preferred under the Bond and not against Mr. Boss, Preferred's principal'. The Complaint (filed seven months after Nichols' initial demand) alleged that Mr. Boss, the principal on the Bond, "misappropriated . . . those monies entrusted to him." (R. 1) (App. A.2). The Complaint sought damages against Preferred under the Bond based upon Mr. Boss' alleged misappropriation of the monies, but contained no separate count or claim against Preferred for "bad faith" or any assertion that Preferred was liable independent of its principal's actions, only that is was liable as surety under the Bond. (R. 1) Therefore, the only stated basis for Preferred's liability was the clear terms of the Bond and its obligations as surety.

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[1]Since Mr. Boss is the father of the minors, it is obvious that Nichols chose not to try to recover any of the funds Mr. Boss allegedly "misappropriated" without court approval, because any monies recovered based upon a judgment against Mr. Boss would ultimately impact the financial status of the minors. Preferred was therefore the logical sole target for the suit under the Bond.

For these reasons, the cases Nichols cites (Initial Brief, pp. 15-16) as supporting the public policy of discouraging insurers from contesting valid claims and to reimburse successful policyholders forced to sue to enforce their policies are not applicable to this appeal or the initial cause of action against Preferred under the Bond as pleaded by Nichols in her Complaint. Further, the Summary Final Judgment entered by the Trial Court made no findings that Preferred was liable for "bad faith" or "misconduct". The Trial Court determined for the first time that, "The award of attorney's fees is based on Preferred's own actions in failing to make payment under the Bond. . . ." in the Order (R. 146). However, that statement by the Trial Court is not based on any cause of action raised in the Complaint, any evidence in the appellate record, nor is it supported by any of the case law cited by Nichols.

Nichols assertion begs the question of Preferred's underlying liability which is based solely upon the failure of its principal to carry out his duties as guardian, as finally demonstrated in Nichols' Request for Admissions, not based on Preferred's failure to pay on the unsubstantiated demand of Nichols. Preferred's liability for Mr. Boss's failure to fulfill his duties was not judicially established until the Trial Court entered Summary Final Judgment ; therefore Preferred's duty to pay under its Bond did not arise until the Final Summary Judgment was a final non-appealable

judgment. Nichols implies that Preferred had no intention of paying the judgment and that she was forced to "move for the issuance of a writ of garnishment . . . to collect her judgment against Preferred." (Initial Brief, p. 4). In reality, Nichols obtained her Writ of Garnishment *two days prior* to the Summary Final Judgment becoming final -- during which Preferred had the right to consider whether or not to appeal the judgment and the imposition of pre-judgment interest.

As a result, Nichols implies that Preferred should be punished and liable for attorney's fees for its actions in delaying payment, rather than its liability for attorney's fees resulting from the actions of its principal. In essence, Nichols is asking this Court to recede from *American Surety Co. Of New York v. Gedney, 185* So. 844 (Fla. 1939) which held that an award of damages (which include attorney's fees) may not exceed the penal sum of the bond. The distinction between misconduct of the principal and the surety spoken of in *Gedney* is not relevant in the present appeal because the alleged misconduct of Preferred was not pleaded nor proven.

For the foregoing reasons, Nichols' argument that § 744.357, Fla. Stat. does not restrict the Trial Court's award of attorney's fees (because the attorney's fees are to come directly from Preferred based upon its own alleged misconduct, and not from the property of the minors) is not supported by fact or law. Thus, the holding

of the First District Court of Appeal that the attorney's fees in this case are limited by the § 744.357, Fla. Stat. should be upheld.

II. LIABILITY UNDER THE BOND MAY NOT EXCEED THE PENAL SUM OF THE BOND UNLESS THE BOND ITSELF OR THE STATUTE AUTHORIZING THE BOND ALLOWS THE PENAL SUM TO BE EXCEEDED.

There are a myriad of cases, beginning with *Gedney, supra,* which clearly state that the liability of a surety may not exceed the penal sum of the bond for an award of damages, such as attorney's fees. See *Aetna Casualty & Sur. Co. v. Buck,* 594 So. 2d 280 (Fla. 1992); *Coppenbarger Homes, Inc. v. Williamson, 611 So.* 2d 33 (Fla. 1st DCA 1992); St. *Paul Mercury Ins. Co. v. Dept. Of State, 581 So.* 2d 976 (Fla. *1* st DCA *1991); Fidelity & Deposit Co. of Maryland v. LA Centre Trucking, Inc.,* 559 So. 2d 1242 (Fla. 4th DCA *1990); City National Bank of Miami v. Centrust Sav. Bank,* 530 So. 2d 317 (Fla. 3d DCA 1988); *Ohio Casualty Ins. Co. v. Oakhurst Homes, Inc.,* 512 So. 2d 1156 (Fla. 2d DCA 1987); and *Traveler's Indemniry Co. v. Askew,* 280 So. 2d 469 (Fla. 1 st DCA 1973).

Nichols attempts to distinguish *Aefna, supra,* and *DiStefano Construction, Inc. v. Fidelity and Deposit Co. of Mary/and,* 597 So. 2d 248 (Fla. 1992) upon which the First District Court of Appeal relied to support the decision to restrict the award of attorney's fees to the penal sum of the Bond. She points out that neither opinion

indicated that the attorney's fees being sought against the surety were for delay or bad faith in not making payments under the bond, but rather that the attorney's fees were sought as a result of the principal's actions, not the surety's actions. As set forth above, this argument relies on the un-asserted "bad faith" claim against Preferred that Nichols now belatedly tries to find in her Complaint. As discussed previously, Nichols' Complaint and the Summary Final Judgment which was entered against Preferred failed to assert or find a cause of action for "bad faith" by Preferred in not paying over the penal sum of the Bond upon Nichols' unsubstantiated demand.

Nichols concedes that the rule established in Travelers, *supra,* limits the recovery to the penal sum of the bond, with interest from the date of breach, unless the wording of the bond or the statute pursuant to which it is given extends the liability of the bond beyond the penal sum. However, she assert that this rule, upon which the First District Court of Appeal relied upon in support of its opinion limiting the attorney's fees assessed against Preferred, somehow does not apply here because the bond involved was a mortgage broker's bond, not a guardianship bond. Moreover, Nichols tries to distinguish the facts in *Askew* and the facts in the present appeal by asserting that "Preferred never offered to make payment under the Bond." (Initial Brief, p.14) Nichols provides no citation to the appellate record for this factual

assertion because there is no factual basis for this assertion. Preferred, just as the surety in *Askew,* withheld payment under the Bond until Nichols' unsubstantiated claim had been supported by the documentary evidence included in Nichols' Request for Admissions. As shown in Nichols' Request for Admissions, the amount misappropriated by Mr. Boss *was* less than Nichols' original demand for the penal sum of the Bond -- demonstrating that Nichols' demand was not accurate or substantiated at the time it was made. (R.24-44). Nichols now tries to shift the burden of her delay in documenting and substantiating her claim to Preferred and then calls it -- in 20-20 hind sight -- "bad faith" on the part of Preferred not to pay merely because she demanded. Upon examination of the statutory Bond form used by Preferred which was attached to Nichols' Complaint (R.5) (App.A. 5) and § 744.357, Fla. Stat., it is crystal clear that neither contain any wording "which . . . indicates an intention to extend the liability of the bond beyond the maximum sum stated therein." *Askew,* at 471 . Thus, the foregoing case law supports the First District Court of Appeal's decision to limit attorney's fees to the penal sum of the Bond.

III. THE DEFINITION OF "INSURER" UNDER § 624.03, FLA. STAT., WHILE IT INCLUDES SURETY FOR PURPOSES OF ATTORNEY'S FEES, SAID DEFINITION DOES NOT CHANGE THE FUNDAMENTAL DIFFERENCES BETWEEN SURETIES AND INSURERS.

In an attempt to find case law supporting Nichols' theory that the only limit to an award of attorney's fees under § 627.428, Fla. Stat. is a "reasonableness" standard, she mixes apples and oranges by asserting that Preferred's Bond is analogous to an insurance policy. In each of the cases cited in Nichols' Initial Brief, at pages 18-22, she asserts that the policy limits of the insurance policies are no different than the penal sum of Preferred' Bond. Thus, she argues that since none of the courts restricted the attorney's fees awarded against the insurers to policy limits, Preferred's liability under the Bond should likewise not be limited to the penal sum of the Bond. This reasoning is flawed and insufficient as demonstrated below.

In each of the cases cited by Nichols, the courts upheld the attorney's fee award based on the successful prosecution of "bad faith" claims against the insurance companies for their refusal to pay the entire claims until after law suits were filed. See Employers' *Liability Assur. Corp. v. Royals Farm Sup., 186 So.* 2d 317 (Fla. 2d DCA 1966), *Cincinnati Insurance Co.v. Palmer,* 297 So. 2d 96 (Fla. 4th DCA 1974) and *State Farm Fire & Casualty Co. v. Pa/ma,* 524 So. 2d 1035 (Fla. 4th DCA 1988). However, in the present appeal, Preferred was never sued for "bad

faith" by Nichols. As stated previously, this Court has held that a separate and distinct cause of action exists for the insured or injured (as a third-party beneficiary) to sue and recover damages against its insurer for an excess judgment on the basis of "bad faith" conduct or handling of a lawsuit or claim. *Thompson v. Comm. Union Ins.* Co. *Of New* York, 250 So. 2d 259 (Fla. 1971). No cause of action for "bad faith" was pleaded or established by Nichols against Preferred in the present case on appeal, and thus the cases cited by Nichols are not relevant to this Court's inquiry.

Further, Nichols' attempt to lump a surety and an insurance company together in one category requires this Court to ignore the distinct differences that exist between a contract for a surety bond and a policy of insurance. While § 624.03, Fla. Stat. may define a "surety" and an "insurer" the same for the purposes of liability for attorney's fees, it does not and can not alter the keys distinctions between them and differences in the nature of their obligations. A "surety" is defined as, "One who undertakes to pay money or to do any other act *in the event that his principal fails therein."* (Emphasis added). *Black's Law Dictionary* 1293 (5th ed. 1979). While an "insurer" is defined as, "One who assumes risk or underwrites a policy, or the underwriter or company with whom contract of insurance is made." Black's *Law Dictionary 726* (5th ed. 1979).

In Dealers *Ins. Co., Inc. v. Centennial Casualty Co., 644 So.* 2d 571 (Fla. 5th DCA 1994) the court stated:

> The point of suretyship is that it offers a secondary source for collection of monies due contractually.
>
> A surety bond is an instrument of secondary liability defined by its express terms. See *Aronson v. Ahringer, 322 So.* 2d 634 (Fla. 3d DCA 1975). It is not a contract of indemnity.

Dealers at 574.

The court in *Dealers* went on to reverse the award of attorney's fees.

It is precisely because surety bonds and insurance policies are different that the courts have consistently held that a surety is not liable for damages in excess of the penal sum of its bond for the actions of its principal. Nichols' suggestion that this Court treat these differing contractual obligations the same merely because both "surety" and "insurer" are included in the same definition in § 624.03, Fla. Stat. would completely change the prevailing law in Florida and create unimaginable chaos in the insurance/surety community -- a result clearly not intended by the Florida Legislature when it amended § 624.03, Fla. Stat. to include "surety" in the definition of insurer. As a result, Nichols analogy theory should be ignored.

CONCLUSION

This Court should affirm the First District Court of Appeal's decision that the amount of attorney's fees sought by Nichols is limited to the penal sum of the Bond. The liability of Preferred (as surety) to Nichols only arises under the express terms of the Bond and upon the judicial determination that the actions of its principal, Mr. Boss, were in violation of his guardianship obligations. Neither Nichols' Complaint, nor her Motion for Summary Judgment, nor the Summary Final Judgment asserts or establishes a "bad faith" cause of action against Preferred independent of Preferred duties as surety. Rather, Nichols' claim was made against Preferred under the Bond upon which it is liable only if it is proven that its principal misappropriated his children's monies.

Nichols' assertion that her claim was valid and conclusive against Preferred from the date she made her demand is erroneous and, if accepted, deprives Preferred of its ability to assert its own defenses and defenses on behalf of its principal since it was not involved in the underlying probate matter resulting in the Order Removing Guardian. The issue of Mr. Boss' failure to perform and Preferred's liability was first established by the Trial Court in the Summary Final Judgment entered on April 5, 1995, not the date of Nichols' demand letter. Therefore,

Preferred had no duty to pay Nichols' claim under the Bond until the Summary Final Judgment was final.

The Florida Courts have made it absolutely clear that the penal sum of a bond cannot be exceeded by an award of attorney's fees. Nichols' attempt to extend the Florida Supreme Court's holding in *Gedney* to include attorney's fees, flies in the face of the clear holding of that case. No subsequent cases have changed the law in Florida that only prejudgment interest, not attorney's fees, may exceed the penal sum of a bond.

For all of the foregoing reasons, this Court should affirm the First District Court of Appeal's decision which is consistent with current Florida law and which reverses the Trial Court's award of attorney's fees to Nichols which exceeded the penal sum of Preferred's Bond. Additionally, this Court should answer the certified question in the affirmative, qualified by the limitation that such attorney's fees and costs shall not cause the total damages and costs to exceed the penal sum of the Bond.

Dated this 24th day of March, 1997.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that true and correct copy of the foregoing has been furnished to John C. Taylor, Esquire, and Marsa S. Binion, Esquire, 50 N. Laura Street, Suite 3500, Jacksonville, Florida 32202, by hand delivery this 24th day of March, 1997.

Koko Head
Attorney

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