IN THE SUPREME COURT OF FLORIDA

UNITED STATES FIRE
INSURANCE COMPANY,

Petitioner,

v.

Case No. SC05-1295

FIRST HOME BUILDERS
OF FLORIDA,

D.C. Case No. 2D 03-134
L.T. Case No. 01-5533CA

Respondent.
_____/

AMICUS BRIEF OF AMWEST SURETY INSURANCE COMPANY

On Discretionary Conflict Review of
a Decision of the Second District Court of Appeal

DUANE A. DAIKER
STEVEN G. SCHEMBER
SHUMAKER, LOOP & KENDRICK, LLP
101 East Kennedy Boulevard
Suite 2800
Tampa, Florida 33602
ddaiker@slk-law.com (E-mail)
(813) 229-7600 (Telephone)
(813) 229-1660 (Fax)

Attorneys for Amicus Curiae
Amwest Surety Insurance Company

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STATEMENT OF INTEREST OF AMICUS CURIAE

Prior to June, 2001, AMWEST SURETY INSURANCE COMPANY ("AMWEST") was a licensed surety company engaged in the business of writing and administering performance bonds on construction projects throughout the State of Florida. In June, 2001, AMWEST was placed into liquidation and receivership by the State of Nebraska. While AMWEST has not written new bonds since that date, AMWEST continues to administer and perform under many bonds issued in Florida prior to that date.

AMWEST has been frequently subjected to performance bond claims relating to damage caused to a completed construction project by the faulty work of a subcontractor. AMWEST is the only amicus curiae presenting the perspective of a surety, a key player in most construction disputes, which is not otherwise represented by the parties to this action. Although many of the other amicus curiae insurance companies, including the majority of the members of the Complex Insurance Claims Litigation Association, also issue surety bonds in addition to CGL policies, these carriers only present argument in this appeal that favors the presumably more lucrative CGL lines of insurance.

SUMMARY OF THE ARGUMENT

Petitioner and other CGL insurers are systematically mischaracterizing the nature of the coverage sought by Respondent First Home pursuant to the "products-completed operations hazard" provisions of the standard CGL policy language. The express language of the policy provides coverage for damage to property caused by the defective work of subcontractors that manifests after the project has been completed. Petitioner has attempted to divert this Court's scrutiny of the legal issues relating to the interpretation of this contractual language by trumpeting manufactured public policy concerns that are inapplicable to the this case.

The opinion below merely acknowledges coverage for a narrow category of damages—i.e., the identifiable and insurable risk that a subcontractor may cause damage to the project that is not discovered until the project is complete. This standard CGL policy language was carefully crafted to provide exactly this type of coverage. Respondent First Home is not seeking coverage for its own defective work, and there is no reason why insureds cannot obtain coverage of this type. Petitioner must be forced to honor the contractual commitments embodied in its own insurance policies, and not be permitted to hide behind an amorphous shield of "public policy." The decision below should be affirmed.

ARGUMENT

I. Petitioner and other CGL insurers systematically mischaracterize the nature of the coverage sought by Respondent First Home under the "products-completed operations hazard" exception to a coverage exclusion.

In this litigation, and in the trial courts throughout this state, CGL insurers are repeating the mantra that CGL policies do not provide coverage for a contractor's own faulty workmanship. *See, e.g.,* Petitioner's Initial Brief, at p. 7-9, 38-43.[1] Insurers make this argument because it is clearly defensible under the policy language and the existing case law, and the argument seems to strike a sympathetic chord for those examining public policy implications. This characterization of the issue, however, is entirely misleading under the facts of this case and similar cases.

[1] As an example, Petitioner leads off its Summary of the Argument in its Initial Brief with the proposition that Florida law has consistently held there is "no coverage under a CGL policy for the cost of repairing and replacing a defective product or contractor's faulty workmanship." *See* Petitioner's Initial Brief, at p. 7. Petitioner further argues that the lower court decision concerns "repair and replacement of the contractor's own work." *See* Petitioner's Initial Brief, at p. 8. Petitioner's argument culminates with a public policy argument that contractors should not be able to recover for their own faulty work. *See* Petitioner's Initial Brief, at p. 43-49. All of these arguments relating to coverage for the contractor's own faulty work are irrelevant, and apparently designed to mislead this Honorable Court.

Standard CGL policies, as promulgated by the Insurance Services Office ("ISO"), by their express terms, exclude coverage for damage to a contractor's own work, or damage caused by a subcontractor's work. *See* CGL Insuring Agreement, at §I (2) (j) and (l). Specifically, coverage is excluded for damage to, or caused by, "your work," which means work performed by the contractor or on the contractor's behalf, or materials furnished in connection with such work. *See* CGL Insuring Agreement, at §V, ¶21. When a contractor performs substandard work on a project, the express terms of the policy exclude coverage for such substandard work. Contrary to Petitioner's repeated assertions, insured contractors are not free to obtain a CGL policy, do substandard work, and then require the insurer to pay for repair or replacement. All of the "gloom and doom" public policy arguments advanced by Petitioner and its amici are red herrings, designed to distract this Court from the true legal issues.[2] Coverage for the defective or substandard work of the insured contractor was *never* the issue below,

[2] Interestingly, in approximately 42 pages of argument in Petitioner's Initial Brief, there are no references to, and essentially no discussion of, the actual language of the contract of insurance—which was the clear focus of the Second DCA below. *See* Petitioner's Initial Brief, at p. 7-49.

and yet Petitioner and its amici spend countless pages arguing this well-established, but entirely irrelevant, principal of law.

Respondent, First Home Builders of Florida ("First Home"), is seeking coverage for damage to property caused by the *defective work of subcontractors* that manifested itself *after* the project was completed.[3] This is a critical distinction that appears to be completely ignored, and purposely so, by the Petitioner and its amici. In desperation, Petitioner and other CGL insurers resort to irrelevant and inapplicable public policy arguments to confuse and conceal their express contractual liability pursuant to their own carefully crafted contracts of insurance.

II. No public policy concerns exist to justify a judicial nullification of the plain language of the standard CGL policy that provides coverage for property damage caused to a project by a subcontractor that manifests after completion of the work.

Petitioner is quick to attack the well-reasoned decision of the Second DCA below on "public policy" grounds, all while mischaracterizing the policies that are implicated under the instant facts. While Florida courts are generally not permitted to re-write insurance policies on the basis of public

[3] AMWEST concurs with the holding below, and concurs with the legal argument made by counsel for Respondent First Home in its Answer Brief, establishing coverage pursuant to the clear terms of the policy.

policy concerns,[4] the policy concerns raised in this instance are not even legitimate. Petitioner contends that Florida public policy should not permit recovery by lazy or incompetent contractors, who are likely to "receive initial payment for [their] work," then perform substandard work, and then "receive subsequent payment from the insurance company to repair and replace" the defective work. *See* Petitioner's Initial Brief, at p. 45 (*quoting Centex Homes Corp. v. Pre-Stress Systems, Inc.*, 444 So. 2d 66, 67 (Fla. 3d DCA 1984)). Setting aside the obvious question as to why an owner would pay initially for defective work, the Petitioner clearly does not think very highly of the construction industry. Petitioner's grievous concern, however, over the alleged "culture of interested carelessness," again has *no bearing on the facts of this case*.[5] *See* Petitioner's Initial Brief, at p. 47.

[4] Florida courts generally do not insulate insurance companies from unusual risks, or otherwise invalidate the contractual insuring relationship, based upon public policy concerns. *See* Respondent's Answer Brief, at p. 45-46. Courts must be very cautious in proceeding down such a slippery slope.

[5] The term "interested carelessness," which seems somewhat oxymoronic in nature, dates back to the mid-nineteenth century, where it was used by fire insurance companies to describe a moral hazard that creates loss. Tom Baker, *On the Genealogy of Moral Hazzard*, 75 TEX. L. REV. 237, 248-49 (1996). The term fell largely into disuse until resurrected in Petitioner's Initial Brief.

Respondent First Home is not seeking coverage for its own faulty construction, and there is no indication that First Home would profit from its own carelessness. First Home is seeking insurance coverage for damage caused to a project by faulty work performed by a subcontractor that was discovered after the work was completed. *J.S.U.B., Inc. v. United State Fire Insurance Co.*, 906 So. 2d 303, 304 (Fla. 2d DCA 2005). Petitioner's purported policy concerns, that contractors will profit from their own carelessness or negligence in completing a project, bear no relationship to the issues decided below, and border on nonsense when considered in the proper factual context of this case. And yet, Petitioner urges this Court to nullify the clear policy language establishing coverage for First Home's claim, based upon Petitioner's frivolous "the sky is falling" policy arguments that the lower court's holding will allow contractors to be paid twice for every job undertaken. Petitioner's policy arguments amount to little more than a subterfuge for the weak legal arguments seeking reversal of the Second DCA's decision below.

The actual public policy concerns implicated by the this case are far different from those advanced by the Petitioner. The Second DCA's decision, in addition to enforcing the clear language of the insurance policy at issue, supports public policy and the protection of innocent insureds against

insured risks for which a premium was paid and coverage expected. The real issue to be addressed by this Court is whether coverage exists, under the standard CGL policy language in question, for damage caused to a project by defective products or defective work, provided by a subcontractor of the insured, which is discovered after the project is completed.

The concept behind the "products-completed operations hazard" coverage in CGL policies is to protect the insured contractor from liability for damages to the project that are caused by another party and beyond the contractor's reasonable control. This is achieved through the interaction of three provisions of the insuring agreement. First, there is no coverage for damage caused to the project by the insured contractor's own work. This falls squarely into the "your work" exclusion to coverage. *See* CGL Insuring Agreement, at §V, ¶21. Thus, there are no legitimate concerns that the insurer will recover for its own poor work. There is an exception for property damage done to "your work" if the damage is caused by the work of a subcontractor. *See* CGL Insuring Agreement, at §I, ¶2(1). As a further limitation, however, the coverage only applies if the damage fits within the "products-completed operations hazard" definition, which means that the work must have been complete when the property damage manifests itself—

i.e., the "occurrence" under the policy. *See* CGL Insuring Agreement, at §I, ¶2(j)(6); §V, ¶16(2).

The ISO, an insurance industry group, who drafted the model CGL provisions at issue, carefully crafted the provisions at issue to insure only against risks the insured could not reasonably control.[6] As an example, the insured contractor is not covered for its own defective work. The insured is similarly not covered for the work of its subcontractor, to the extent that the damage manifests itself during the course of the project. This coverage structure makes logical sense, in that the insured contractor should be supervising the work of the subcontractor during the course of the project. Similarly, the insured contractor has a degree of control over the

[6] Prior to 1986, the basic form CGL policy *did not* include coverage for completed operations and included named insured's "work" and "product" exclusions. These pre-1986 exclusions excluded both "property damage to work performed by or on behalf of the named insured" and "property damage to the named insured's products." These exclusions were often referred to as the "Business Risk Exclusions." Prior to 1986, contractors who wished to purchase expanded completed operations coverage under the basic pre-1986 CGL policy did so by purchasing a separate endorsement, called a Broad Form Property Damage Endorsement. However, the ISO changed the form in 1986 to clarify the intent of the coverage under the ISO form CGL policy. *Collett v. Insurance Co. of the West*, 75 Cal. Rptr. 2d 165 (Cal. Ct. App. 4th Dist. 1998), points out that the purpose of the changes in the 1986 policy was to reemphasize the industry's intent to afford coverage for subcontractors' defective work.

subcontractor because the insured contractor holds the purse strings, and can withhold payment for a subcontractor's defective work. It is sensible, and comports with good public policy, to make the insured contractor responsible for its own work product, and for supervision of work done in the course of the project.

The "products-completed operations hazard" coverage at issue, however, goes one step further in offering protection to the insured contractor for a further foreseeable risk. The insured contractor is covered for damage done to the project by a subcontractor's work that manifests itself *after the project is completed*. When damage manifests itself after the work is completed, the insured contractor is still liable to the owner for damages resulting from the subcontractor's work. At that time, however, the project has been completed, the subcontractor has been paid, and the insured contractor has little practical recourse against the subcontractor. Clearly, this is a foreseeable and insurable risk.

The actual coverage at issue in this litigation is a far cry from Petitioner's characterization as providing windfall profits for lazy, incompetent or fraudulent contractors. The ISO standard CGL policy form, through the "products-completed operations hazard" provision, has identified and provided coverage for a very real risk that the insured

contractor may face liability for damage to a project caused by the work of a subcontractor that manifested itself after the project was complete. Why shouldn't an insured contractor be able to insure against this loss? Public policy does not prohibit sophisticated insurance companies from offering coverage for identifiable risks that occur in the course of construction projects, and the insurance companies have certainly accepted the premium payments for such coverage. At some point, after issuing a wealth of these policies with the standard CGL coverage language, CGL insurance companies, like Petitioner, realized they had underestimated the degree of risk inherent in this coverage, and have tried to disavow coverage.

Undoubtedly, Petitioners will contend that the insured contractors are still insuring their own defective work, by saying that defective work by a subcontractor manifesting itself after completion should have been discovered during the course of the project by proper supervision by the insured contractor. Ultimately, such facts may create a factual issue as to when the "occurrence" takes place, but that does not change the coverage provided by the clear language of the policy. The Petitioner, and other insurers using the ISO form, identified a risk and provided specific coverage tailored to insure that risk, charged and accepted a premium for the coverage,

and should not be allowed to avoid its liability when an insured seeks to enforce the bargained-for policy provisions.

III. The holding below does not have the effect of converting a CGL policy into a performance bond.

Petitioner has represented to this Court that the holding in the lower court, finding coverage for damage to the project caused by the work of a subcontractor that manifests after the completion of the project, has the effect of converting the CGL policy into a performance bond. *See* Petitioner's Initial Brief, at p. 38-43. This argument is nothing but an extension of Petitioner's specious public policy arguments. Petitioner's claim is based upon the assertion that the lower court's holding provides insurance coverage to First Home for its own faulty work. As discussed above, the *J.S.U.B.* opinion below does not hold that First Home is insured for its own work, and Petitioner continues to try and divert this Court's attention from the actual holding below. *See supra* Part II.

Petitioner is certainly correct that insurance and suretyship are vastly different concepts. Sureties often get lumped into the same categories as insurers, and are actually defined as "insurers" under Florida law. FLA. STAT. §624.03. Surety bonds are, at their essence, a financial guarantee of

the principal's performance.[7] Surety underwriting is based upon the financial and technical qualifications of the principal who is bonded. While surety bonds are, in theory, "zero loss" products, in which the surety expects indemnity from its principal, the reality often clashes with the theory when a construction project goes awry.

The decision below, forcing Petitioner to honor the coverage described in the language of the CGL policy, does not change the nature of the insuring relationship between Petitioner and First Home. Petitioner is still not responsible for the faulty work of First Home, and is still not guaranteeing First Home's performance or contractual obligations. Likewise, Petitioner is not exposed to any additional liability that should not have been foreseen when the policy language was carefully crafted. The argument that Petitioner is being saddled with bond-like obligations, or the "risk of moral hazard," is simply further mischaracterization of the holding below. Providing coverage for an identifiable and quantifiable risk of property damage that is caused by a third party subcontractor, and that is beyond the

[7] In the simplest terms, a performance bond is nothing more than a contract, and the relationship between the parties to the bond is contractual in nature. *American Home Assurance Co. v. Larkin Gen. Hosp*., 593 So. 2d 195, 198 (Fla. 1992).

control or purview of the insured, is not the same as guaranteeing the insured's performance.

Petitioner also contends that insurance companies are at a disadvantage in covering these types of losses, as compared to a surety, because insurance companies do not have a right of "reimbursement" from the insured. *See* Petitioner's Initial Brief, at p. 40, 43. While an insurance company, by terms of the insurance contract, is not entitled to indemnity from its insured, the insurer does have subrogation rights against any third party causing a loss. Petitioner, after paying for damages caused to the project by the subcontractor, has standing to sue the subcontractor to recover such losses. More importantly, the risk inherent in insuring such losses is an integral part of the insurance business, which is founded on the principal of pooling risk. The availability of subrogation or indemnity rights in a particular situation should be irrelevant. Petitioner, and other CGL insurers, are in the business of evaluating risks and charging appropriate premiums for such coverage. Nothing about the decision below changes any aspect of the insurance relationship, except that it confirms the availability of coverage for a particular type of loss occasioned by the defective work of a third party that manifests after the completion of the project.

The parties agree that insurance and suretyship are vastly different. The fact that coverage has been confirmed for the insured, for a narrow category of damages caused by a third party, does not change the nature of the insurance contract. Petitioner's argument that the holding below has created a de facto performance bond shows a misunderstanding of suretyship, as well as a mischaracterization of that holding. While the Petitioner seeks to avoid its own contractual liability, and shift the loss to its insured's surety or directly to its own insured, that was not the deal that was struck. At the inception of a construction project, the risks are allocated amongst all parties–the owner, the contractor, the insurer, the surety (if present), and others–by contract. Petitioner evaluated the risk, wrote and issued the policy with products-completed operations hazard coverage included, and accepted the premium—and now must be held to the terms of its own contract for insurance.

CONCLUSION

For all the foregoing reasons, AMWEST SURETY INSURANCE COMPANY respectfully requests this Court affirm the decision of the Second District Court of Appeal below.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Amicus Brief of Amwest Surety Insurance Company has been furnished via U.S. Mail to the following Service List this 7th day of August, 2006.

_____/s_____
Attorney

Service List

Ronald L. Kammer, Esquire rkammer@hinshawlaw.com Valerie M. Jackson, Esquire vjackson@hinshawlaw.com Sina Bahadoran, Esquire sbahadoran@hinshawlaw.com Hinshaw & Culbertson LLP 9155 South Dadeland Blvd., Suite 1600 Miami, FL 33156 Telephone: (305) 358-7747 Facsimile: (305) 577-1063 *Counsel for Petitioner*	David K. Miller, Esquire dmiller@broadandcassel.com Broad and Cassel 215 S. Monroe St., Suite 400 Tallahassee, FL 32301 Telephone: (850) 681-6810 Facsimile: (850) 681-9792 *Counsel for Florida Home Builders Association and National Association of Home Builders*
Joseph R. Miele, Esquire jmiele@adorno.com Adorno & Yoss 350 East Las Olas Blvd., Suite 1700 Fort Lauderdale, FL 33301 Telephone: (954) 763-1200 Facsimile: (954) 766-7800 *Counsel for Petitioner*	R. Hugh Lumpkin, Esquire hlumpkin@vpl-law.com Michael F. Humber, Esquire mhuber@vpl-law.com Stephen A. Marino, Jr., Esquire smarino@vpl-law.com Ver Ploeg & Lumpkin, P.A. 100 S.E. 2nd St., Suite 2150 Miami, FL 33131 Telephone: (305) 577-3996 Facsimile: (305) 577-3558 *Counsel for Arvida/JMB Partners, L.P.; Arvida/JMB Managers, Inc.; Arvida Mgmt. Limited Partnership and Mercedes Homes, Inc.*

June Galkoski Hoffman, Esquire jhoffman@fowler-white.com Fowler White Burnett, P.A. Esperito Santo Plaza, 14th Fl. 1395 Brickell Avenue Miami, FL 33131-3302 Telephone: (305) 789-9249 Facsimile: (305) 789-9201 *Counsel for Petitioner*	Pamela A. Chamberlain, Esquire Mitrani, Rynor & Adamsky, P.A. One S.E. Third Avenue Miami, FL 33131 Telephone: (305) 358-0050 Facsimile: (305) 358-0550 *Counsel for Mid-Continent Casualty Co.*
Donna M. Greenspan, Esquire dgreenspan@eapdlaw.com Edwards Angell Palmer & Dodge LLP One North Clematis Street, Suite 400 West Palm Beach, FL 33401 Telephone: (561) 820-0249 Facsimile: (561) 655-8719 *Counsel for Petitioner*	Denise V. Powers, Esquire 2600 Douglas Road, Suite 501 Coral Gables, FL 33134 Telephone: (305) 444-5100 Facsimile: (305) 444-4455 *Counsel for National Assoc. Mut. Ins. Co.*
Patrick J. Wielinski, Esquire Cokinos, Bosien & Young, P.C. 2221 East Lamar Blvd., Suite 750 Arlington, TX 76006 Telephone: (817) 608-9533 Facsimile: (817) 649-3300 *Counsel for Assoc'd General Contractors of America; FL A.G.C. Counsel, Inc.; The Assoc.'d General Contractors of Greater FL, Inc.; South Florida Chapter of the Assoc'd General Contractors/FL East Coast Chapter of Assoc'd General Contractors of America/American Subcontractors Assoc.; American Subcontractors of Florida*	Daniel J. Santaniello, Esquire Luks & Santaniello, L.L.C. 515 East Las Olas Boulevard, Suite 1100 Ft. Lauderdale, FL 33301-4203 Telephone: (954) 761-9900 Facsimile: (954) 761-9940 *Counsel for Poole & Kent Co.*
John Bond Atkinson, Esquire Rebecca A. Brownell, Esquire Ellie A. Levy, Esquire Atkinson & Brownell, P.A. One Biscayne Tower, Suite 3750 2 South Biscayne Boulevard Miami, FL 33131 Telephone: (305) 376-8840 Facsimile: (305) 376-8841 *Counsel for Amerisure Mut. Ins. Co* .	William D. Horgan, Esquire Fuller, Johnson & Farrell P.O. Box 1739 Tallahassee, FL 32302-1739 Telephone: (850) 224-4663 *Counsel for Complex Ins. Claims Litigation Assoc.*
Warren H. Husband, Esquire whh@metzlaw.com Metz, Hauswer & Husband P.O. Box 10909 Tallahassee, FL 32302-2909 Telephone: (850) 205-9000 Facsimile: (850) 205-9001 *Counsel for Assoc'd General Contractors of*	Perry N. Bass, Esquire P.O. Box 5216 Houston, TX 77052 Telephone: (281) 359-7400 Facsimile: (281) 359-7446 *Counsel for Hartford Fire Ins. Co.*

America	
Christopher W. Martin, Esquire Levon G. Hovnatanian, Esquire Martin, Disiere, Jefferson & Wisdom, LLP 808 Travis, Suite 1800 Houston, TX 77002 Telephone: (713) 632-1700 Facsimile: (713) 222-0101 *Counsel for Hartford Fire Ins. Co.*	

Respectfully Submitted:

SHUMAKER, LOOP & KENDRICK, LLP

By: _____/s_____

DUANE A. DAIKER
Fla. Bar No. 8280
STEVEN G. SCHEMBER
Fla. Bar No. 267600
101 East Kennedy Boulevard
Suite 2800
Tampa, Florida 33602
ddaiker@slk-law.com (E-mail)
(813) 229-7600 (Telephone)
(813) 229-1660 (Fax)
Attorneys for Amicus Curiae
Amwest Surety Insurance Company

CERTIFICATE OF COMPLIANCE

I HEREBY CERTIFY that this Amicus Brief is printed in a 14 point size Times New Roman font, and otherwise complies with Rule 9.210(a)(2), Florida Rules of Appellate Procedure.

_____/s_____
Attorney