IN THE SUPREME COURT OF FLORIDA

CASE NO: SC05-1295
L.T. CASE NO: 2D 03-134

UNITED STATES FIRE INSURANCE COMPANY,

Petitioner,

v.

FIRST HOME BUILDERS OF FLORIDA,

Respondent.

_____________________________________/

INITIAL BRIEF ON THE MERITS OF PETITIONER, UNITED STATES FIRE INSURANCE COMPANY

ON DISCRETIONARY CONFLICT REVIEW OF A DECISION FROM THE SECOND DISTRICT COURT OF APPEAL

HINSHAW & CULBERTSON LLP
Ronald L. Kammer
Fla. Bar No. 360589
Valerie M. Jackson
Florida Bar No. 170135
Sina Bahadoran
Florida Bar No. 523364
9155 S. Dadeland Blvd., Suite 1600
Miami, FL 33156

ADORNO & YOSS LLP
Joseph R. Miele, Jr.
Fla. Bar No. 0426636
350 East Las Olas Blvd., Suite 1700
Fort Lauderdale, FL 33301

FOWLER WHITE BURNETT P.A.
June Galkoski Hoffman
Fla. Bar No. 050120
1395 Brickell Avenue, 14th Floor
Miami, FL 33131-3302

EDWARDS ANGELL PALMER & DODGE LLP
Donna M. Greenspan
Fla. Bar No. 059110
One North Clematis St., Suite 400
West Palm Beach, FL 33401

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STATEMENT OF THE CASE

On December 19, 2002, the Circuit Court of Lee County entered Final Declaratory Judgment in favor of United States Fire Insurance Company ("U.S. Fire") against J.S.U.B., Inc., and LOGUE Enterprises, Inc., as partners of First Home Builders of Florida, a joint venture (collectively, "First Home"). First Home appealed and the Second District Court of Appeal reversed. *J.S.U.B. v. United States Fire Ins.*, 906 So. 2d 303 (Fla. 2d DCA 2005) (referred to as "*JSUB*"). U.S. Fire timely filed a Notice to Invoke Discretionary Jurisdiction and this Court accepted jurisdiction on April 5, 2006.

STATEMENT OF FACTS

First Home, a general contractor, sought coverage under two consecutive commercial general liability ("CGL") insurance policies issued by U.S. Fire. First Home sought coverage for the cost of repairing or replacing its defective work, asserting that because the defective work was occasioned by the negligence of its subcontractors, U. S. Fire must satisfy First Home's contractual obligations to its customers. (R. 4, ¶15). When U.S. Fire disclaimed coverage, First Home sued U.S. Fire for declaratory relief. (R. 1-59).

1. Stipulated Facts

The case went to a non-jury trial on the following stipulated facts recited by the trial court:

> 1. That [FIRST HOME] is a home builder who was contracted by prospective homeowners to build several homes in the Lehigh Acres area.
>
> 2. That the homes built by FIRST HOME in the Lehigh Acres area were damaged by FIRST HOME'S faulty workmanship stemming from its subcontractors' use of poor soil, improper soil compaction and testing.
>
> 3. That the damage to the homes appeared after the completion of the subject homes and their delivery to the respective homeowners.
>
> 4. That Defendant/Counterplaintiff, U.S. FIRE INSURANCE COMPANY refused to provide coverage to FIRST HOME for the repair costs associated with the faulty workmanship under two general liability policies issued to FIRST HOME, policy numbers 503178958 (04/24/99 – 04/24/00) [the "1999 Policy"] and 5430828249 (04/24/00 – 04/24/01) [the "2000 Policy"].
>
> 5. That FIRST HOME filed an action for declaratory relief against U.S. FIRE on June 7, 2001, to determine whether coverage existed.
>
> 6. That U.S. FIRE agreed to provide coverage for consequential damages such as damage to homeowners' wall paper and other damages that are not part of the cost of repairing FIRST HOME's contracted product as promised in its building contracts for the construction of the subject homes.
>
> ***

(R. 469).

2. Policy Provisions

Both the 1999 Policy and the 2000 Policy (collectively, "Policies") contain the following provisions:

SECTION I – COVERAGES

COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement[1]

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . . But:

(1) The amount we will pay for damages is limited as described in Section III – Limits Of Insurance . . .

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes in the "coverage territory"; and

(2) The "bodily injury" or "property damage" occurs during the policy period.

***

2. Exclusions

This insurance does not apply to:

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[1] The Insuring Agreement in the 2000 policy was amended by an endorsement entitled "**AMENDMENT TO INSURING AGREEMENT – KNOWN INJURY OR DAMAGE**", however, the operative provision remained the same in both Policies.

a. Expected or Intended Injury

"Bodily injury" or "property damage" expected or intended from the standpoint of the insured. This exclusion does not apply to "bodily injury" resulting from the use of reasonable force to protect persons or property.

***

j. Damage To Property

"Property damage" to:

***

(5) That particular part of real property on which you or any contractors or subcontractors working directly on your behalf are performing operations, if the "property damage" arises out of those operations; or

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

***

Paragraph (**6**) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

l. Damage To Your Work

"Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard".

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

***

SECTION V – DEFINITIONS

***

13. “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

***

16. “Products-completed operations hazard”

(a) Includes all “bodily injury” and “property damage” occurring away from premises you own or rent and arising out of “your product” or “your work” except:

(1) Products that are still in your physical possession; or

(2) Work that has not yet been completed or abandoned. However, “your work” will be deemed completed at the earliest of the following times:

(a) When all the work called for in your contract has been completed.

(b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.

(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.

***

17. “Property damage” means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the occurrence that caused it.

***

21. "Your work" means:

a. Work or operations performed by you or on your behalf; and

b. Materials, parts or equipment furnished in connection with such work or operations.

"Your work" includes:

a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work"; and

b. The providing of or failure to provide warnings or instructions.

(R. 275-423).

3. Trial Court Final Judgment

After reviewing the insurance policies and applicable Florida law, the trial court held that the Policies:

> provide no coverage for faulty workmanship and that the damages alleged by FIRST HOME and caused by FIRST HOME's subcontractors' use of poor soil, improper soil compaction and testing are faulty workmanship for which no coverage exists under the subject policies.

(R. 463). The trial court entered final judgment in favor of U.S. Fire. (R. 459-72). First Home appealed. (R. 464-65).

4. Second District Opinion

The Second District reversed and remanded. It articulated two reasons for distinguishing nearly forty years of Florida law: first, the Second District determined that this Court had "broadened CGL coverage" in *State Farm Fire & Casualty Co. v. CTC Development Corp.*, 720 So. 1072 (Fla. 1998), by "expanding the interpretation of what constitutes an 'accident' when that term is not defined in an occurrence-based policy"; and second, because the policy revisions in 1986 added products-completed operations hazard coverage. *JSUB*, 906 So. 2d at 307.

This appeal follows.

SUMMARY OF ARGUMENT

For nearly four decades, Florida law has consistently held that there is no coverage under a CGL insurance policy for the cost of repairing and replacing a defective product or contractor's faulty workmanship. *Escambia Chem. Corp. v. U.S. Fid. and Guar. Co.*, 212 So. 2d 884 (Fla. 1st DCA 1968). Simply put, Florida courts have consistently held that it is not a CGL insurer's responsibility to satisfy a builder's contractual responsibility. Numerous reasons have been pronounced for this established rule of law. This Court's decision in *LaMarche v. Shelby Mutual Insurance Co.*, 390 So. 2d 325 (Fla. 1980) ("*LaMarche*") and those decisions from the First, Second[2], Third, Fourth, and Fifth District Courts of

[2] Prior to *JSUB*, the Second District followed this rule in *Auto-Owners Ins.*

Appeal which have uniformly followed it, conclude that coverage does not lie because faulty workmanship cannot constitute an "occurrence," is not "property damage," or because insurance coverage for defective work, alone, is entirely repugnant to Florida public policy. Consistent among these decisions, however, is the core concept that unlike tort damages, a CGL policy simply is not intended to cover contractual liability faced by a contractor who delivers defective work to its customers in breach of its contractual obligations.

JSUB clouds this reasoned body of law based almost entirely on an erroneous reading of this Court's decision in *State Farm Fire & Casualty Co. v. CTC Development Corp*., 720 So. 2d 1072 (Fla. 1980) ("*CTC*"). *CTC* did not expand the insuring agreement of the 1986 CGL policy as *JSUB* suggests. Unlike the situation present here, that case involved damage to a third party, and not the repair and replacement of a contractor's own work. Thus, not only is *CTC* factually irrelevant to the issue before this Court, properly read, it in fact supports the conclusion that there is no coverage for First Home's claims.

This Court should uphold long-standing Florida law and reaffirm the principle that a CGL policy provides coverage for tort liability only when defective work causes property damage, and not for contractual liability arising from the delivery of defective work. This Court should rule that the claims by First Home

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Co. v. Marvin Dev. Corp., 805 So. 2d 888 (Fla. 2d DCA 2001).

do not satisfy the insuring agreement under the U.S. Fire Policies, as there was no "occurrence" and no "property damage." Further, this Court should rule that coverage here would be contrary to Florida public policy and would impermissibly convert a CGL insurer into a surety that guarantees the performance of quality work. Accordingly, this Court should reverse *JSUB* and reinstate the judgment of the trial court.

STANDARD OF REVIEW

The interpretation of an insurance contract is a question of law that is reviewed *de novo*. *Jones v. Utica Mut. Ins. Co.*, 463 So. 1153, 1157 (Fla. 1985).

ARGUMENT

I. *JSUB* WRONGLY CONCLUDED THAT *CTC* AND 1986 POLICY REVISIONS EXPANDED COVERAGE AFFORDED BY THE INSURING AGREEMENT

When the Second District in *JSUB* found that a standard CGL policy provides coverage for the cost to replace a general contractor's faulty workmanship, it refused to follow the decisions of this Court, four other district courts of appeal and a prior panel of the Second District. The *JSUB* court's decision was based on two patently erroneous premises. First, the court relied on this Court's decision in *CTC*, which it claimed "broadened CGL coverage by expanding the interpretation of what constitutes an 'accident' when the term is not defined in an occurrence-based policy." Second, the court distinguished *LaMarche*

because the standard CGL forms used by the insurance industry were revised to include products–completed operations hazard coverage.

For the reasons discussed below, neither premise is correct. A standard CGL policy does not indemnify contractors for damage to their own work caused by faulty workmanship.

A. *JSUB* Erroneously Concluded that *CTC* Expanded the Insuring Agreement to Encompass the Repair and Replacement of Faulty Workmanship

JSUB relied extensively on this Court's decision in *CTC* in holding that a construction defect claim is an occurrence where there is only damage to the work itself. The facts and legal issues in *CTC*, however, differ significantly from those here.

1. Unlike Here, *CTC* Involved Third-Party Damage

In *CTC*, a builder violated restrictive covenants by constructing a residence beyond the applicable setback lines under the mistaken impression that the homeowner's association had approved his request for a variance. *State Farm Fire & Casualty C. v. CTC Development Corp.,* 720 So. 2d 1072 (Fla. 1998). The neighboring property owners filed suit. *Id.* at 1073. When the insurer denied coverage, the builder sued the insurer. When the trial court granted summary judgment in favor of the insurer, the builder appealed. *Id.* at 1074.

The CGL policy in *CTC* applied only to "bodily injury or property damage caused by an occurrence . . . ." The policy defined an "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions which result in bodily injury or property damage. *Id*. at 1073.

The *CTC* court held that where the term "accident" is not defined, it encompasses not only "accidental events but also injuries or damage neither *expected* nor *intended* from the standpoint of the insured." *Id*. at 1076.[3] *JSUB* failed to consider that the builder's conduct in *CTC* was deemed an "accident" because the defective construction resulted in unintentional and unexpected harm to the innocent neighbors who were not parties to the construction contract. Properly read, the holding in *CTC* is consistent with *LaMarche* because the damages in *CTC* were sustained by a *third party* beyond the contractual obligations owed by the insured to the homeowners. Under *LaMarche* and its progeny, this is exactly the type of damage that a CGL policy is intended to cover. *See Auto-Owners v. Travelers,* 227 F. Supp. 2d 1248, 1261 n.19 (M.D. Fla. 2002) ("In *CTC*, the damages sought were necessarily "property damage" resulting from defective construction rather than the costs to repair or replace the defective

[3] "Expect" is a broad term. One source defines "expect" as: " . . . 2. To consider likely or certain: . . . 3. To consider reasonable or due . . . ." THE AMERICAN HERITAGE DICTIONARY, 476 (2d ed. 1982).

construction because the underlying plaintiffs were third parties--adjoining property owners--rather than the party for whom the contractor had built the defective or faulty construction."); *Comm. Union Ins. Co. v. R.H. Barto Co.,* 440 So.2d 383 (Fla. 4th DCA 1983) ("[A] comprehensive general liability policy is intended to protect an insured from injury incurred by a third party resulting from the insured's faulty workmanship and material. It is not intended to protect the insured from liability for replacement or repair of the defective work or material itself.")[4]. Thus, *CTC* left intact the principles set out by this Court in *LaMarche.*

In stark contrast to *CTC*, this case involves a suit by a builder seeking coverage for delivering faulty work to its customers. First Home entered into contracts to build homes. First Home failed to properly construct the homes in breach of its contractual obligations to the respective homes' owners. The improper construction caused damage to the structures themselves, as opposed to any damage to a third party or damage to property outside the contract. As in this case, when defective construction results only in damage to the home itself

[4] As early as 1968, long before *LaMarche*, Florida law provided no coverage for an insured's failure to deliver a product as bargained for, finding that such claims do not constitute an occurrence within a liability policy. "There is no contention by the customer that the product furnished by [the insured] was so defective as to injure either the customer's person or property, or that his loss resulted from an accident of any kind or nature." *Escambia Chem. Corp.,* 212 So. 2d at 886, 87.

that the insured contracted to deliver, there is no accident and hence no "occurrence" as those are precisely the damages that are "expected."

In *LaMarche,* this Court adopted the New Jersey Supreme Court decision of *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A. 2d 788 (1979), which explained that claims for defective work are not covered because they are ordinary costs of doing business: "The insured-contractor can take pains to control the quality of the goods and services supplied. At the same time he undertakes the risk that he may fail in this endeavor and thereby incur contractual liability whether express or implied. The consequence of not performing well is part of every business venture; the replacement or repair of faulty goods and work is a business expense, to be borne by the insured-contractor in order to satisfy customers." *Id*. at 791– 92.

The court in *Harbor Court Associates v. Kiewit Const. Co.*, 6 F. Supp. 2d 449 (D. Md. 1998),[5] explained this same concept in the specific context of an insured's "expectation" of liability for defective work:

> In the context of a construction project, the word 'expected' refers to damages for which an insured would be liable in any event, irrespective of fault, because of its contractual obligations to construct its product. . . . "[C]ontractors, when they agree to construct a building, expect that they will

[5] In *French v. Assurance Co. of Am.*, 2006 WL 1099471 (4th Cir. 2006), the court, applying Maryland law, held that certain insurers, including U.S. Fire, breached the duty to indemnify to the extent that claims involved the costs to repair otherwise non-defective components of the home. The court, however, also ruled that there was no coverage to repair and replace the insured's own defective work.

> have to erect the building in a proper manner. They further expect that if they do not do so, they will have to repair any defects in their work so as to 'deliver' the product they promised to provide.

Id. at 452. Here, the cost incurred by First Home in order to satisfy its contractual obligations to its customers was a routine, ordinary and expected cost of doing business and not an accident or occurrence under the Policies.

2. Rather Than "Expand" Coverage, *CTC* Merely Incorporated the Pre-1986 Definition of "Occurrence" Into All 1986 CGL Policies

JSUB held that *LaMarche* did not apply to the facts of this case because the Policies provide broader coverage. To reach that conclusion, *JSUB* misapplied *CTC*, erroneously disregarded *LaMarche*, and violated the fundamental principle that an exclusion limits as opposed to creates coverage.

In order to define the term "accident," the *CTC* court considered the "occurrence" definition in pre-1986 CGL policies like the one in *LaMarche.* In those policies, "occurrence" was defined as "an accident, including continuous or repeated exposure to conditions, which result[s] in bodily injury or property damage neither expected nor intended from the standpoint of the insured." *Id.* at 1075-76; s*ee also Dimmitt Chevrolet Inc. v. Southeastern Fidelity Ins. Corp.*, 636 So. 2d 700, 702-03 (Fla. 1993). Under that definition, the Court noted that there would be coverage "not only for an accidental event but also for unexpected injury or damage resulting from the insured's intentional acts." *CTC*, 720 So. 2d at 1075. The court adopted that definition because it found it "comports with the language

used in standard comprehensive liability policies and with the definition of the term accidental set forth in *Dimmitt* as unexpected or unintended."[6] 636 So. 2d at 704.

Thus, contrary to the erroneous conclusion drawn by *JSUB*, *CTC* did not broaden coverage in the post-1986 policies. *CTC* merely incorporated into the definition of occurrence, the meaning of "accident" that was expressly included in the policy at issue in *LaMarche*.[7] Accordingly, the definition of occurrence adopted by this Court in *CTC* is consistent with *LaMarche,* and *JSUB* erred when it found *LaMarche*[8] inapplicable and no longer controlling.

3. ***CTC* Did Not Alter the Principle that an Exclusion Limits Coverage and Does Not Create Coverage**

As discussed above, the 1986 revisions affect the coverage analysis only if the damages fall initially within the insuring agreement, which under Florida law

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[6] In *Dimmitt*, the court interpreted CGL policies that provided coverage to Dimmitt from 1972-1980. The policy defined an "occurrence" as "an accident including continuous or repeated exposure to conditions, which result in bodily injury or property damage neither expected nor intended from the standpoint of the insured."

[7] The "expected or intended" concept was not only incorporated into the 1986 policy's "occurrence" requirement, but it is further expressed in Exclusion (a) which precludes coverage for "property damage expected or intended from the standpoint of the insured."

[8] Prior to *JSUB*, all of the cases following *LaMarche*, concluded that the insuring agreement in a commercial general liability policy does not provide coverage for faulty workmanship. Accordingly, it is irrelevant that some of these cases interpret post 1986 policies and some of them interpreted pre-1986 policies.

they do not. *JSUB* thus compounded its error by improperly using the language of the exclusions to bolster its conclusion that the policy provided coverage in the first instance.

Before being affirmed by the Florida Supreme Court, the Second District in *Shelby Mutual Insurance Company v. LaMarche*, 371 So. 2d 198, 200 (Fla. 2d DCA 1979), acknowledged that "it is well settled that an exclusion does not provide coverage but limits coverage." In that case, the homeowners filed suit against the building contractor for structural defects arising from the contractor's failure to properly construct the home. Shelby insured the contractor under a CGL policy. On appeal, the Second District relied on the principle that an exclusion does not create coverage to conclude that the CGL policy was not designed "to be a guarantee of an insured's satisfactory performance of his contractual duties." *Id.*

Ironically, *JSUB* avoided that important principle to reason that the exclusions in the 1986 revisions suggest that coverage exists in the first instance: "while the exclusion does not create coverage, it is consistent with and provides support for our analysis that the insuring provisions of the policies provide coverage. . . ." 906 So. 2d at 310. The Second District patently erred in relying upon an exclusion to interpret the coverage afforded by the insuring agreement.

B. Cases Decided Before and After *CTC* have Relied Upon *LaMarche* to Hold that CGL Policies Do Not Cover the Repair and Replacement of Faulty Workmanship

In *Home Owners Warranty Corp. v. Hanover Ins. Co.*, 683 So.2d 527 (Fla. 3d DCA 1996), a condominium developer and builder was sued for faulty construction after completion of the project. The developer was insured by Hanover Insurance Company ("Hanover") under a CGL policy. Hanover denied coverage, concluding that the allegations of the complaint did not come within the terms of the insurance policy. The Third District, relying on *LaMarche*, held that there was no duty to defend or indemnify the developer against the condominium association's complaint for breach of implied warranty, negligence, strict liability, and violation of Section 553.84 of Florida Statutes. The court found that each count attributed the damage to the defective work itself. Since no damage outside of the contract was alleged, there was no coverage under the Hanover policy. Here, like *Hanover*, the disputed damages arise solely from the contract.

In *Lassiter Constr. Co., Inc. v. American States Ins. Co.*, 699 So. 2d 768 (Fla. 4th DCA 1997), a general contractor's CGL policy provided coverage for "property damage" caused by an "occurrence". A school board sued the general contractor for breach of contract as the result of poor construction. There were no allegations of bodily injury or property damage to any property other than the structure that the general contractor had agreed to build. The court concluded there was no coverage as "the insured has failed to demonstrate that there are any provisions in the coverage section of the policy which would provide coverage for

this defective work." *Id*. The court recognized that "exceptions for the work performed by subcontractors, cannot create coverage where there is no coverage in the first place." *Id*. at 770; *see also Centex Homes Corp. v. Pre-Stress Systems, Inc.,* 444 So. 2d 66, 67 (Fla. 3d DCA 1984) ("purpose of comprehensive liability insurance coverage is to provide protection for personal injury or property damage caused by the product only and not for the replacement or repair of the product."); *U.S. Fire Ins. Co. v. Meridian of Palm Beach*, 700 So. 2d 161, 162 (Fla. 4th DCA 1997) (no coverage for defective workmanship under CGL policy); *Aetna Cas. & Sur. Co. of Am. v. Deluxe Sys., Inc.*, 711 So. 2d 1293 (4th DCA 1998) (the "your work" exclusion barred coverage for insured's liability for cost of purchasing and installing replacement shelving, whether insured's work was its product or advice in selecting the shelves); *Keller Indus., Inc. v. Employers Mutual Liability Ins. Co.*, 429 So. 2d 779, 780 (Fla. 3d DCA 1983) (no coverage for cost of repairing and replacing defective products and workmanship).

Hanover and *Lassiter* were both decided prior to this Court's decision in *CTC*. In fact, *CTC* specifically cites *Lassiter*, and did not overrule it. 720 So. 2d at 1074-1075. If the Second District's reading of *CTC* is correct, this Court should have overruled the Third District's opinion in *Hanover* and the Fourth District's opinion in *Lassiter*, since the insurance policies in both cases contained the 1986 CGL revisions with the subcontractor exception. But it did not, and the reason is

simple. *CTC* did not expand the scope of CGL coverage to include the cost to repair or replace the faulty work itself. To the extent *JSUB* held otherwise, it was incorrect.

Several cases decided after *CTC recognized this distinction by holding* that CGL policies — exactly like the ones issued by U.S. Fire here — do not cover the repair or replacement of defective work. *See Sekura v. Granada Ins. Co.*, 896 So.2d 861 (Fla. 3d DCA 2005); *Auto-Owners Ins. Co. v. Tripp Constr., Inc.*, 821 So.2d 1157 (Fla. 3d DCA 2002). In *Sekura*, Ronald and Carol Sekura sued their builder after they learned their home was constructed in violation of FEMA and Monroe County elevation requirements and "thus did not meet [the] requirements of the parties' contract." *Sekura*, 896 So. 2d at 861.

Granada sued for declaratory relief seeking a determination that it had no obligation to defend. The Third District, relying on *LaMarche*, found that the cost of repairing and replacing faulty construction was not covered by Granada's CGL policy since the policy provides protection for property damage caused by the completed work – not for the cost to replace or repair defective work. *Id*. at 862.

In *Auto-Owners v. Tripp*, the homeowners sued their general contractor because their home was not delivered in accordance with the contract. Auto-Owners denied coverage and was sued by Tripp. The case was bifurcated into two separate class-action lawsuits. The first phase involved damages by the

homeowners to repair and/or replace the contractor's poor work. The court, expressly relying upon *LaMarche*, held:

> For coverage and the duty to defend to arise, the Complaint would have to allege that there was damage to some personal property … that resulted from the defective workmanship ... . The first phase dealt with the claims of the homeowners against the construction company for damages that the homeowners suffered in connection with repairs and/or replacing, etc. the actual defects in the construction of the homes, particularly related to the roofs of the homes. As to the first phase of litigation, relating to the foregoing, the type of damages being sought are not the type covered by the policy in question . . . .

Tripp, 821 So.2d at 1158; *Auto-Owners Ins. Co. v. Marvin Development Corp*., 805 So. 2d 888 (Fla. 2d DCA 2001) (business risk exclusions precluded coverage for contractor who built home on construction site which was improperly prepared).

The *JSUB* court erred in relying on *CTC* for the proposition that a builder's failure to perform under the contract is an "occurrence." Applying the reasoning in *LaMarche*, *CTC*, *Hanover*, *Lassiter*, *Sekura*, and *Tripp*, amongst others, there is no coverage here because the only disputed damages were to the insured's work alone. Accordingly, there is no occurrence, and hence no coverage for First Home's claims under the Policies.

II. OTHER JURISDICTIONS AGREE THAT THE REPAIR AND REPLACEMENT OF FAULTY WORKMANSHIP IS NOT AN OCCURRENCE

Numerous treatises and cases from around the country have held that damage to the insured's work product standing alone is not an occurrence. After surveying the law, one leading insurance treatise observed:

> The majority of jurisdictions have held that breach of contract is not an occurrence … . [A] claim for faulty workmanship, in and of itself, is not an occurrence under a commercial general liability policy because a failure of workmanship does not involve the fortuity required to constitute an accident.

Lee R. Russ & Thomas F. Segalla, *Couch on Insurance,* §129:4 (3d ed. 1998).

For example, the Missouri Court of Appeals explained: "[B]reach of a defined contractual duty cannot fall within the term 'accident.'" *Hawkeye-Security Ins. Co. v. Davis*, 6 S.W.3d 419, 426 (Mo. App. 1999) (quoting *American States Ins. Co. v. Mathis*, 974 S.W.2d 647, 650 (Mo. App. 1998)). "Performance of [the] contract according to the terms specified therein was within the insured contractor's control and management and its failure to perform cannot be described as an undesigned or unexpected event." *Id*.

The highest courts of many states agree with this interpretation of a standard CGL policy. For example, the Supreme Court of Iowa in *Pursell Construction v. Hawkeye-Security Ins. Co.*, 596 N.W.2d 67 (Iowa 1999), held that defective work which does not cause damage to other property is not an occurrence. In reaching its decision, the court noted the existence of conflicting authority, but joined "those jurisdictions that hold that defective workmanship standing alone, that is, resulting

in damages to the work product itself, is not an occurrence under a CGL policy." *Id*. at 71.

In *Oak Crest Constr. Co. v. Austin Mut. Ins. Co.*, 998 P.2d 1254 (Ore. 2000), the general contractor sued its insurer when it failed to reimburse it for the cost of removing and replacing a subcontractor's painting work. The insurance policy in *Oak Crest* defined "occurrence" to mean "an accident that includes repeated exposure to similar conditions." The court found that damages arose solely from a breach of contract since there was no other damage, concluding that the problem "in this case was not 'caused by accident' within the meaning of the plaintiff's commercial liability policy." *Id*. at 1258.

In *U.S. Fidelity & Guar. Co. v. Warwick Dev. Co., Inc.*, 446 So. 2d 1021 (Ala. 1984), a buyer contracted to buy a home from a builder. The buyer found defects throughout the structure and filed suit against the builder, alleging unworkmanlike construction. The builder tendered the suit for defense to two CGL carriers, who denied coverage. The USF&G policy, like the Policies here, defined "occurrence" as "an accident, including continuous or repeated exposure to conditions . . . ." *Id.* The Alabama Supreme Court considered whether the USF&G policy provided coverage for faulty workmanship and noncomplying materials. The court reasoned, "[a]fter a review of the record and policy involved, we

conclude that the trial court incorrectly held that USF&G was bound under its policy of insurance to [the builder]." *Id*. at 1024.

Recently both the West Virginia and South Carolina Supreme Courts reiterated that poor workmanship, standing alone, does not constitute an occurrence under the standard policy definition of this term. *Webster County Solid Waste Auth. v. Brackenrich & Assocs., Inc.*, 617 S.E.2d 851, 856 (W.Va. 2005); *L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 621 S.E.2d 33, 36-37 (S.C. 2005).

In *Webster*, the insured was sued pursuant to a contract for faulty workmanship in the design, engineering, and inspection of a landfill. That contract obligated the contractor to inspect and supervise the construction. The *Webster* court cited its prior decision in *Corder v. William W. Smith Excavating Co.,* 556 S.E.2d 77, 82 (W. Va. 2001), and explained:

> The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to completely replace or rebuild the deficient product or work. This liability, however, is not what a CGL policy was designed to protect against. Rather, a CGL policy is designed to protect policyholders for tort liability for physical damage to others — not for the business risk of contractual liability of the insured for economic loss because the insured's completed work is not that for which the damaged person bargained.

The court correctly concluded that the policy's completed operations provision could not be evoked unless there was an occurrence, and since faulty

workmanship was not within the scope of a traditional CGL policy, coverage did not exist under the policy.

In *L-J*, a general contractor subcontracted for site preparation. The general contractor was sued when the subcontractor's inadequate clearing of tree stumps caused the road surface to deteriorate and fail. The appellate court held that the damage to the pavement was accidental damage. The Supreme Court of South Carolina reversed, holding that a general contractor could not shift to a CGL insurer the risk of economic loss associated with defective work, as faulty workmanship does not constitute an "occurrence." The court noted the "majority" of jurisdictions holding that "faulty workmanship standing alone, resulting in damage only to the work itself, does not constitute an occurrence." 621 S.E.2d at 36. Applying that logic, the court reasoned:

> We find these negligent acts constitute faulty workmanship, which damaged the roadway system only. And because faulty workmanship is not something that is typically caused by an accident or by exposure to the same general harmful conditions, we hold that the damage in this case did not constitute an occurrence.

Id. at 123.

In addition to state supreme courts, several Federal circuit courts have also endorsed this approach. For example, in *Burlington Ins. Co. v. Oceanic Design & Constr., Inc.*, 383 F.3d 940 (9th Cir. 2004), the court considered the question under Hawaii law whether a company which contracted to build a house is covered under

its CGL policy for claims brought against it by dissatisfied homeowners. Like the case here, the homeowners alleged that the builder improperly designed and/or constructed the foundation of the residence, causing earth movement and resulting physical and structural damage to the residence. The builder, relying on allegations of "negligent breach of contract", tendered the suit to its insurer. *Id*. at 945. In addition to finding that coverage was precluded by Hawaii's public policy, the court noted that contract and contract-based tort claims are not within the scope of CGL policies under Hawaii law, since there is no occurrence that triggers an insurer's duty to defend.

In *ACS Constr. Co., Inc. of Mississippi v. GCU*, 332 F.3d 885 (5th Cir. 2003), the builder contracted with the U.S. Army Corps of Engineers to construct munitions bunkers. The contractor entered into a subcontract to install waterproofing membrane, which later leaked. In that subcontract, the subcontractor accepted all responsibility for the work. The court recognized the core of the dispute was whether the installation of the faulty waterproofing membrane which resulted in "the consequential leaks constitute[d] an occurrence." *Id*. at 888. The court, interpreting a provision identical to the Policies here, found that the leaks resulting from the breach of contract were not accidental and therefore not an occurrence. In addition, the court rejected the insured's contention

that the subcontractor exception and Exclusion *l.* created coverage, as this interpretation would transform a CGL policy into a performance bond.

Accordingly, the law around the country is well reasoned that the natural result of poor workmanship does not constitute an "occurrence."

- *Nabholz Constr. Corp. v. St. Paul Fire & Marine Ins. Co.*, 354 F. Supp. 2d 917, 922 (E.D. Ark. 2005) ("This court predicts that the Arkansas Supreme Court would elect to join the majority of courts in jurisdictions throughout the country which have concluded that defective workmanship does not constitute an occurrence on policies such as the one here");

- *Union Ins. Co. v. Hottenstein*, 83 P.3d 1196, 1201 (Colo. Ct. App. 2003) (explaining that "an accident is an unanticipated or unusual result flowing from a commonplace cause" and that "poor workmanship constituting a breach of contract is not a covered occurrence");

- *Amerisure, Inc. v. Wurster Const. Co., Inc.*, 818 N.E.2d 998, 1005 (Ind. App. 2004) (defective work of a general contractor was not an occurrence, declining to follow Minnesota law regarding the effect of the 1986 modifications to the "your work" exclusion since those revisions did not alter the fundamental purpose of a CGL policy);

- *H.E. Davis & Sons, Inc. v. North Pacific Ins. Co.,* 248 F. Supp. 2d 1079, 1084-85 (D. Utah 2002) ("Plaintiff failed to adequately compact the soil with natural and foreseeable results. So long as the consequences of Plaintiff's work were natural, expected or intended, they cannot be considered an accident");

- *American Home Assurance Company v. AGM Marine Contractors, Inc.*, 379 F. Supp. 2d 134, 136 (D. Ma. 2005) ("faulty workmanship . . . does not constitute an occurrence and therefore, there is no coverage under the policy" where the only damage sustained was to the insured's own work, noting that the court relied on the "weight of authority" in reaching its decision);

- *Brosnahan Builders, Inc. v. Harleysville Mut. Ins. Co.*, 137 F. Supp. 2d 517, 526 (D. Del. 2001) (claims for faulty construction which were clearly

within the control of the general contractor were not a fortuitous circumstance, and therefore the damage to the home was not caused by an occurrence);

- *Custom Planning & Dev. v. American Nat'l Fire Ins. Co.*, 606 S.E.2d 39, 41 (Ga. App. 2004) (where there is no property damage other than to the work itself as "a consequence of faulty workmanship, then there has been no occurrence");

- *Hastings Mut. Ins. Co. v. Feinbloom*, 2006 LEXIS 888 (Mich. App. 2006) ("The first step of this court's inquiry is to determine whether coverage exists according to the general insuring agreement. Because the damages were solely to the insured's work, constituting a breach of contract, the damages are excluded from coverage because there was no occurrence");

- *Solcar Equip. Leasing Corp. v. Pennsylvania Mfr. Ass'n Ins. Co.*, 606 A.2d 522, 527 (Pa. Super. 1992) ("Appellants erroneously contend that Solcar's substandard performance, which contributed to massive property damage in the Regency Hill homes, makes this claim a covered one. We are not shocked that Solcar's slipshod construction work caused the homes to be of little value. However, this was not an accident or occurrence, a prerequisite under the insurance contract for reimbursement");

- *Baker Residential Ltd. Partnership v. Travelers Ins. Co.*, 10 A.D.3d 586, 587 (N.Y. App. 1st Dep. 2004) (improper installation of flashing and waterproofing is "a classic faulty workmanship/construction contract dispute" and "the damages sought therein did not arise from an occurrence . . . as contemplated by the policy");

- *Cincinnati Ins. Co. v. Venetian Terrazzo, Inc.*, 198 F. Supp. 2d 1074 (E.D. Mo. 2001) (the alleged negligence in pouring the cement sub-floor was not an "occurrence" within the meaning of the insurance policy since an accident does not encompass the negligence or breach of contract in the insured's performance of its contract work; such cannot be described as an undesigned or unexpected event);

- *State Farm Fire & Casualty Co. v. Tillerson*, 777 N.E.2d 986, 990-91 (Ill. App. Ct. 2002) (insurer was not obligated to defend a contractor who was sued for breach of warranty for building over a cistern without taking precautions to prevent the soil from settling, as the damages to the home

were an ordinary consequence of the contractor's defective work and were therefore not accidental);

- *Viking Constr. Mgmt.. v. Liberty Mut. Ins. Co.*, 813 N.E.2d 1, 7 (Ill. App. Ct. 2005) (insurer owed no duty to defend Viking because the complaint alleging that a building wall had collapsed because it was not properly braced failed to allege an occurrence, since CGL policies do not cover breach of contract or defective construction claims).

In addition to these cases, courts in ten other states and two other circuits have also agreed with decisions of these courts that construction defect claims where there are no damages outside the contract do not qualify as an occurrence.[9] This Court should adhere to *LaMarche* and join the courts of at least twenty-six other states and four Federal Circuits and reverse *JSUB*.[10]

III. FAULTY WORKMANSHIP IS NOT "PROPERTY DAMAGE" CAUSED BY AN OCCURRENCE

In pertinent part, the insuring agreement in the Policies limit coverage to "property damage" that is "caused by an 'occurrence.'" The term "property damage" is defined to mean: "Physical injury to tangible property, including all

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[9] *See, e.g.,* Arizona – *U.S. Fid. & Guar. Corp. v. Advance Roofing & Supply Co., Inc.*, 788 P.2d 1227 (Ariz. Ct. App. 1989); California – *Ray v. Valley Forge Ins. Co.*, 77 Cal. App. 4th 1039 (2d Dist. 1999); Louisiana – *Fredeman Shipyard, Inc. v. Weldon Miller Contractors, Inc.*, 497 So.2d 370 (La. Ct. App. 3rd Cir. 1986); Minnesota – *Western Nat. Mut. Ins. Co. v. Frost Paint & Oil Corp.*, 1998 WL 27247 (Minn. Ct. App. 1998); Ohio – *Heile v. Herrmann*, 736 N.E.2d 566 (Ohio Ct. App. 1st Dist. 1995); Wyoming – *Action Ads, Inc. v. Great Am. Ins. Co.*, 685 P.2d 42 (Wyo. 1984).

[10] Courts in several states are split on this issue. One example is Ohio. In three other states, the issue of whether faulty workmanship is an occurrence is presently before their respective Supreme Courts.

resulting loss of use of that property. . . ." For precisely that reason, economic losses resulting from a contractor's failure to deliver a home that satisfies the terms of its contract, in the first place, cannot constitute property damage. *Lazzara Oil Co. v. Columbia Cas. Co.*, 683 F. Supp. 777, 780-91 (M.D. Fla. 1988) (allegations of price-fixing were for economic damages, not "damage or injury to tangible property . . . Such pure economic losses do not constitute damage or injury to tangible property"); *Peoples Tel. Co., v. Hartford Fire Ins. Co.*, 36 F. Supp. 2d 1335, 1341 (S.D. Fla. 1997) (misappropriated electronic serial numbers and mobile telephone identification numbers are intangible and cannot constitute "property damage"); *Old Republic Ins. Co. v. West Flagler Assocs., Ltd.*, 419 So.2d 1174, (Fla. 3d DCA 1982) (diminution in value of winnings in betting pool not "property damage"); *Couch on Ins.* §129:1 (3d ed. 2005) ("a commercial general liability insurance policy is generally designed to provide coverage for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or work is not that for which the damaged person bargained").

This Court has explained that "[e]conomic losses are, simply put, disappointed economic expectations" and has defined such losses as "damages for inadequate value, costs of repair and replacement of [a] defective product or consequent loss of profits." Economic loss "includes the diminution of value of

the product because it is inferior in quality and does not work for the general purposes for which [it] is manufactured or sold." *Indemnity Ins. Co. v. American Aviation, Inc.* 891 So. 2d 532, 536 (Fla. 2004) (citing *Casa Clara Condominium Assoc. v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244 (Fla. 1993)).

Several Florida courts have found that the cost of repairing and replacing a general contractor's unsatisfactory work is not "property damage" covered under a CGL policy. In *West Orange Lumber Co., Inc. v. Indiana Lumbermens Mut. Ins. Co.*, 898 So.2d 1147 (Fla. 5th DCA 2005), a lumber company contracted to provide "No-Hole Select Cedar" in connection with construction at Walt Disney World. At some point, Disney questioned the quality of cedar provided by West Orange and ordered the contractors to remove and replace the cedar that had been installed. The general contractor on the project filed suit against West Orange, in part for failing to "provide the proper grade of cedar siding", as the cedar provided "did not meet the owner's specifications . . . ." *Id.* at 1148. In a resulting coverage dispute between West Orange and its CGL insurer, the trial court granted summary judgment for the insurer. On appeal, the Fifth District affirmed and expressly agreed with the trial court, recognizing:

> [W]ith regard to the Commercial General Liability Policy, there were no allegations of property damages and … the dispute concerned a breach of contract, not a tort. Failure to supply a product specified in a contract is a business risk not covered by the liability policy issued by Indiana. ... [T]he allegations in the complaint show the owner or general contractor's property suffered no damage from the failure to

> supply the correct quality of lumber. The only damage alleged was the cost or expense to the vendor to remove the defective product and supply an acceptable substitute.

Id. at 1148.

Equally compelling is the opinion in *Auto Owners Ins. Co. v. Tripp Const., Inc.*, 737 So.2d 600 (Fla. 3d DCA 1999). In *Tripp*, the homeowners sued the general contractor for faulty workmanship. The court reasoned that a CGL policy "only protects against *personal injury* or *damages to personal property* which might *result from* the defective workmanship." *Id.* at 601 (emphasis in original). Consequently, the court ruled that "the type of damages being sought are not of the type covered by the policy in question and, consequently, the appellant has no duty to cover or defend those claims." *Id.*

This Court's decision in *Casa Clara* likewise supports the conclusion that defective work alone is not "property damage", explaining:

> Generally, house buyers have little or no interest in how or where the individual components of a house are obtained. They are content to let the builder produce the finished product, i.e., a house. These homeowners bought finished products – dwellings – not the individual components of those dwellings. They bargained for the finished products, not their various components. The concrete became an integral part of the finished product and, thus, did not injure "other" property.

Id. at 1247.

Here, the defective soil and subsequent cracking of the structure was part and parcel of the completed work delivered by First Home pursuant to its

construction contracts with its customers. Since this damage is not damage to "other property," it can not, by definition, qualify as "property damage" caused by an occurrence. The contractor in this case constructed a neighborhood of defective houses. The fact that the damage became apparent after delivery does not make the faulty construction "property damage" that the insurer must now repair or replace in better condition than it was upon delivery to the homeowners.

Courts in numerous jurisdictions outside of Florida have expressly concluded that defective work, alone, does not qualify as "property damage" caused by an occurrence. In *Wm. C. Vick Const. Co. v. Pennsylvania Nat. Mut. Cas. Ins. Co.*, 52 F. Supp. 2d 569 (E.D.N.C. 1999), the court held that there was no "property damage" for a contractor's faulty workmanship under the exact same definition in the Policies. In *Vick*, a general contractor was sued in connection with faulty roof construction in constructing an addition to an office building. In the subsequent coverage action, the court focused on the definition of "property damage." Since the claims were limited to the cost of repairing the contractor's faulty work, the court astutely observed that there could not be any property damage. It reasoned as follows:

> Under the clear language of the policies, property damage requires either (1) a "physical injury to" or "destruction of" tangible property, or (2) "loss of use of tangible property which has not been physically injured or destroyed[.]" These requirements, in this court's opinion, infer that the property allegedly damaged has to have been undamaged or uninjured at some previous point in time. This is inconsistent with

> allegations that the subject property was never constructed properly in the first place.

Id. at 582. Accordingly, the court ruled, that there was no coverage for the contractor's faulty work because the threshold requirement for "property damage" was not satisfied. *See also Hobson Const. Co., Inc. v. Great Amn. Ins. Co.*, 322 S.E.2d 632, 635 (N.C. App. 1984) (same). *Vick* was subsequently affirmed by the Fourth Circuit. *See Wm. C. Vick Const. Co. v. Great American Ins. Co.*, 213 F.3d 634 (4th Cir. 2000).

Numerous other courts have also found that the cost of repairing faulty workmanship is not "property damage" caused by an occurrence. *See, e.g., Reliance Ins. Co. v. Mogavero*, 640 F.Supp. 84, 86 (D. Md. 1986) ("Property damage" definition "exclude[s] defective work performed by the insured"); *Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 266 F.3d 859, 862-64 (8th Cir. 2001) (holding that under Missouri law, the term "property damage" defined as "physical injury to tangible property" does not cover losses due to the insured's negligent performance of contract work, where the defective work does not cause accidental injury to surrounding property); *R.N. Thompson & Associates, Inc. v. Monroe Guar. Ins. Co.*, 686 N.E.2d 160, 163 (Ind. App. 1997) (faulty construction does not involve "physical injury to tangible property"); *Amerisure, Inc. v. Wurster Const. Co., Inc.*, 818 N.E.2d 998, 1003-04 (Ind. Ct. App. 2004) ("faulty workmanship or defective materials does not insure 'property damage' as that term is defined and

used in Wurster's CGL policy"); *Assurance Co. of America v. Dusel Builders, Inc.*, 78 F. Supp. 2d 607, 609 (W.D. Ky. 1999) (cause of action relating to contractor's failure to perform under the contract "did not constitute property damage."); *George A. Fuller Co. v. U.S. Fidelity and Guar. Co.*, 200 A.D. 255, 259, (N.Y. App. Div. 1994) (same); *Cincinnati Insurance Co. v. Venetian Terrazzo, Inc.*, 198 F. Supp. 2d 1074, 1079 (E.D. Mo. 2001) ("property damage" is defined, in part, as "physical injury to tangible property" and does not cover losses due to the insured's negligent performance of contract work, where the defective work does not cause accidental injury to surrounding property).

Here, the only damages subject to this litigation are those incurred by First Home in repairing and replacing its own defective work because it failed to deliver the homes free of defect in accordance with its contracts. Since the homes were never properly constructed to begin with, they were damaged at the time of completion and delivery. There was no property damage caused by an occurrence and the claims by the owners against First Home were solely for economic losses arising from First Home's breach of contract. Such claims against First Home do not fall within the insuring agreement as they do not qualify as property damage caused by an occurrence.

IV. COMPLETED OPERATIONS COVERAGE PROTECTS A CONTRACTOR FROM TORT LIABILITY CAUSED BY ITS SUBCONTRACTOR'S FAULTY WORK; IT DOES NOT PROTECT A CONTRACTOR FROM ITS OWN CONTRACTUAL LIABILITY

In *Tucker Construction Co. v. Michigan Mutual Insurance Company*, 423 So. 2d 525 (Fla. 5th DCA 1982), the court analyzed a CGL policy where, as here, the damage caused by the faulty workmanship of a subcontractor did not occur until the construction project was completed. In that case, the general contractor entered into an agreement with a property owner to construct a restaurant. *Id.* at 526. The contractor purchased a CGL policy and subsequently added coverage for completed operations. *Id.* After completion of the restaurant, the floor began to settle, and the contractor blamed the construction defect on its subcontractor, the soil testing firm. *Id.* at 526, 528. The contractor sued its insurer for coverage. The trial court entered summary judgment in favor of the insurer finding that the policy in question did not provide coverage for the damages to the restaurant. *Id.*

On appeal, the contractor argued that the completed operations hazard coverage should cover the damages to the completed restaurant resulting from the "negligence of [its] soil testing subcontractor." 423 So. 2d at 528. The Fifth District rejected this argument, finding that the insured had failed to deliver the completed "work"; *i.e.*, the restaurant, "in accordance with his contractual undertaking with the owner." *Id.*

The court in *Tucker* noted that "Florida case law recognizes a difference between liability for injuries to the person or property of others caused by the negligent acts of the insured and damages to the product being constructed or on

which the contracted services are being performed." *Id.* at 527 (citing *LaMarche)*. The court held that liability coverage, such as a CGL policy, covers tort *but not contractual liability*:

> A manufacturer or a contractor or other person performing services for others faces two types of potential liability. One is contractual liability for failure to perform the contractual obligation and to deliver a product or service as agreed. The other is the usual potential tort liability attendant to all activity that results when one fails to use due care and thereby causes others personal injury or property damage. . . . [I]n either event, liability coverage does not cover the contractual liability involved.

Id. at 526-27 (emphasis supplied).

Although the damage in *Tucker* resulted from the "negligence" of the soil testing subcontractor, *see* 423 So. 2d at 528, the court considered this as the general contractor's *contractual* liability and thus not covered by the CGL policy. This is consistent with the holding in *LaMarche* that the purpose of CGL coverage "is to provide protection for personal injury or for property damage *caused by* the completed product, but *not for the replacement and repair of that product*." 390 So. 2d 326 (emphasis supplied).

The court explained that a contractor can obtain coverage for *tort* liability in the form of "premises/operations" coverage for work in progress, or "products/completed operations" coverage for completed work. Thus, whether "tort liability" is covered depends on the type of coverage maintained by the insured and whether the damage from the tort occurs during operations or after the

operations have been completed. *Id.* at 527.

As in *Tucker*, the Policies include both "operations" and "Products – Completed Operations" coverage. Also as in *Tucker*, the damage resulting from the subcontractors' negligent work did not appear until after construction was complete, and the damaged property was the defective construction itself.[11]

Courts after *Tucker* have agreed that the completed operations hazard does not provide coverage for a contractor's *contractual* liability arising from the faulty workmanship of the contractor or its subcontractor. These courts came to the same conclusion as the *Tucker* court *despite the intervening 1986 revisions to the CGL policy*.

In *Lassiter Construction Co. Inc. v. American States Insurance Co.*, 699 So. 2d 768 (Fla. 4th DCA 1997), the fourth district held:

> Exclusion j.(6), on which the insured relies because it does not apply to "property damage" included in the "Products-completed operations hazard," does not create coverage under this policy. Assuming there is "products-completed operations hazard" coverage in this policy, such coverage does not cover the type of contractual liability alleged against the general contractor in this case.

Id. at 770 (emphasis supplied). In *Home Owners Warranty Corp. v. Hanover Ins. Co.*, 683 So.2d 527 (Fla. 3d DCA 1996), the third district similarly found that the

[11] As the trial court noted, U.S. Fire had already agreed to provide coverage for damage to the homeowners' wallpaper and other damages "that are not part of the cost of repairing First Home's contracted product as promised in its building contracts for the construction of the subject homes." (R. 469).

products completed operations coverage of a CGL policy does not provide coverage for contractual liability a contractor faces for delivering faulty work, but instead, provides coverage for tort liability for physical damage to others caused by the completed work. *Id.* at 529, 30 (exclusion (l) "does not, in and of itself, create coverage.").

Finally, in *Auto Owners Ins. Co. v. Travelers Cas. & Surety Co.,* 227 F. Supp. 2d 1248 (M.D. Fla. 2002), the general contractor's surety contended that the "products-completed operations hazard" within the "new" CGL policies "provides for coverage for the costs to repair and replace defective construction." *Id.* at 1263. The court disagreed, finding that "[t]his argument was considered and rejected in *Lassiter*." *Id. See also West Orange Lumber Co., Inc. v. Indiana Lumbermens Mut. Ins. Co.*, 898 So.2d 1147, 1148 (Fla. 5th DCA 2005) (rejecting the argument that the addition of products/completed operations coverage would insure construction or contract deficiencies).

V. THE DECISION BELOW THREATENS TO CONVERT A CGL POLICY INTO A *DE FACTO* PERFORMANCE BOND OR WARRANTY

U.S. Fire issued First Home a CGL insurance policy, not a performance bond. CGL coverage is insurance, while a performance bond is a line of credit. In other words, they are two fundamentally distinct products premised on different underlying theories of risk and offering different types of protection. Under the

Second District's ruling, the Policies were essentially converted into a performance bond to the extent that they now provide coverage for the cost of repairing and replacing First Home's faulty workmanship.

The concept of "insurance" is the creation of pooled risk among a group of potential claimants. If an accident or loss occurs to any member in the pool, it is spread over the premiums received from the entire pool. David Barru, *How to Guarantee Performance on International Construction*, Geo. Wash. Int'l L. Rev. at 54 (2005). In an insurance policy, "an insurance carrier has no right of subrogation against its own insured." *Bulone v. United Services Auto. Ass'n*, 660 So.2d 399, 404 (Fla. 2d DCA 1995). Since there is no personal exposure to the insured, the concept of "fortuity" or accident is essential; otherwise, an insured is able to create a culture that promotes loss, which is then shifted to the insurer. This notion is known as the risk of "moral hazard."

In the early nineteenth century, as insurance products became more pervasive in the marketplace, insurers began to recognize that "interested carelessness," poor business practices, and over-insurance are all "moral hazards that increased the probability of loss." Tom Baker, *On the Genealogy of Moral Hazard*, Texas Law Review at 248-49 (1996). As early as 1904, this Court recognized the risk of moral hazard in an insurance policy. *L'Engle v. Scottish Union & Nat. Fire Ins. Co.*, 37 So. 462, 466 (Fla. 1904) (in the context of over-

insurance in fire coverage). The provisions of the Policies, like all CGL policies, reflect the requirement of fortuity and the avoidance of moral hazard.

A performance bond is not insurance.[12] The two most fundamental distinctions between insurance and a performance bond are that a bond operates on the theory of "zero loss" and a surety has a right to reimbursement from its principal. One court described the principle of zero loss as follows:

> [U]nlike insurance, which contemplates the certainty of losses, sureties do not write performance bonds for principals who appear unable to perform the primary obligation and whose assets are insufficient to meet the contingency of default ... . [B]onds, like loans, are written based on the financial integrity of the principal, premised on the idea that no losses should follow[.]

Cates Constr., Inc. v. Talbot Partners, 980 P.2d 407, 423 (Cal. 1999).

Likewise, the risk of moral hazard in insurance is not present in a bond because the contractor has a common-law and contractual obligation to "reimburse the surety for its reasonable costs incurred in discharging its bond obligations."

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[12] In deciding whether to bond a contractor, the surety rigorously evaluates every aspect of the contractor's ability to complete the project, including: the contractor's technical qualifications; its organizational experience; the experience of key personnel; and its reputation among previous customers. This evaluation is critical. Before the surety will guarantee the obligee, the owner of the construction project, that the construction will be delivered free of defects, it must evaluate the contractor's ability in order to gauge the risk of default and set the premium, which is usually 1-3% of the construction contract. Edward Etcheverry, Florida Construction Law and Practice, Chapter 8, *Rights and Liabilities of Sureties*, Florida Bar (2003). Based on its investigation, the surety will determine the maximum line of credit (bond) it will make available to the contractor.

Philip L. Bruner and Patrick J. O'Connor, Jr., "Surety's equitable rights — Indemnification, Reimbursement and Restitution", Chapter 12, *Suretyship: Assuring Contract Performance,* §12:98. Unlike a surety, a CGL insurer is prohibited from subrogating against its insured. *See also Dyson & Co. v. Flood Engineers, Architects*, 523 So.2d 756 (Fla. 1st DCA 1988); *Western World Ins. Co., Inc. v. Travelers Indem. Co.*, 358 So.2d 602 (Fla. 1st DCA 1978).

For these reasons, a performance bond protects against faulty workmanship, but a CGL policy does not. One leading treatise explained the reasoning:

> The nature of the risk assumed by the party in the role of "insurer" is a major distinction between insurance and the arrangements of guaranty and surety. As a broad general rule, the risk can be characterized in terms of the degree to which the contingency is within the control of one of the parties. In the classic instance of insurance, the risk is controlled only by chance or nature. In guaranty and surety arrangements, the risk tends to be wholly or partially in the control of one of the three parties.
>
> There is also a difference in the liability of a classic insurer and that of a surety/guarantor. An insurer is the primary party liable upon the occurrence of the contingency, and with the occasional exception as to liability insurance and automobile insurance, must bear the ultimate loss. In the classic case of surety or guaranty, on the other hand, the "insurer" is essentially liable secondarily (regardless of how the liability may be labeled for legal analysis). A surety is ordinarily entitled to indemnity from the principal in case the surety is compelled to perform.

Lee R. Russ & Thomas F. Segalla, *Couch on Insurance,* §1:18, at 1-31 (3d ed. 1998).

Courts throughout Florida have examined the insuring provisions of a CGL policy and determined that it covers fortuitous risks, not contractual obligations within the control of the insured. *Hardaway Co. ex rel. Wright Contracting Co. v. U.S. Fire Ins. Co.*, 724 So.2d 588, 590 (Fla. 2d DCA 1998) ("Liability insurance policies, such as the policies involved here, are not performance bonds"); *Auto-Owners Ins. Co. v. Marvin Dev. Corp*., 805 So.2d 888 (Fla. 2d DCA 2001) ("we also note that the Auto-Owners Insurance policies were not warranty policies providing coverage for construction deficiencies or defective workmanship"); *Auto-Owners v. Travelers*, 227 F.Supp. 1248, 1262 (M.D. Fla. 2002) ("*LaMarche* provides that a surety's liability and CGL's liability are not coextensive").

It is evident from these fundamental differences that a CGL policy is not intended or designed to provide "coverage for a product or work performance that fails to meet contractual requirements." *Webster County Solid Waste Auth*. 617 S.E.2d at 851, 853. Rather, "[t]he risk that an owner might reject performance as inadequate is a 'business risk' allocated by parties in contract, and is insured by a performance bond, not general liability insurance intended to provide coverage for injuries or damages resulting from 'accidents.'" *DCB Constr. Co. v. Travelers Indemn. Co.*, 225 F.Supp.2d. 1230, 1231 (D. Col. 2002); *Bonded Concrete, Inc. v. Transcontinental Ins. Co.*, 784 N.Y.S.2d 212, 213 (N.Y. App. 2004) ("[T]he issuer of a commercial general liability insurance policy is not a surety for a construction

contractor's defective work product"); *Nabholz Constr. Corp. v. St. Paul Fire & Marine Ins. Co.*, 354 F.Supp.2d 917, 922 (E.D. Ark. 2005) (a CGL policy "is not intended to substitute for a contractor's performance bond, the purpose of which is to insure the contractor against claims for the cost of repair or replacement of faulty work."); *Keystone Filler & Mfg. Co. v. Amer. Mining Ins. Co.*, 179 F.Supp.2d 432, 439 (M.D. Pa. 2002) ("The purpose and intent of [a CGL] insurance policy is to protect the insured from liability for essentially accidental injury to the person or property of another rather than coverage for disputes between parties to a contractual undertaking").

Here, First Home wants the protection afforded by a performance bond, without the risk of subrogation. But a CGL policy is not a *de facto* performance bond. A CGL insurer, like U.S. Fire, provides defense and indemnity for tort damages, not contractual liability. Unlike a surety, U.S. Fire has no right to reimbursement if the contractor elects to use cheap materials and inexperienced labor in order to maximize its profits. This Court should give meaning to the language of the CGL policy and the fundamental intent behind the concept of insurance coverage, and reverse the decision below.

VI. COVERAGE FOR CLAIMS ARISING OUT OF DEFECTIVE WORKMANSHIP IS REPUGNANT TO FLORIDA PUBLIC POLICY

Beginning with *LaMarche*, this Court recognized that claims for defective construction are not covered under a liability policy, unlike a warranty or

performance bond. In *LaMarche*, the general contractor was sued for poor workmanship and breach of warranty. The Florida Supreme Court considered "whether this coverage [comprehensive general liability] includes payment for the cost of replacing defective materials and workmanship." *Id*. at 326. The court held that coverage did not exist for payment for building flaws, but instead only covered damages caused by those flaws. Adopting the reasoning of the Supreme Court of New Jersey in *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (1979), the Court focused on the intent behind CGL coverage:

> To interpret the policy as providing coverage for construction deficiencies, as asserted by the petitioners and a minority of states, would enable a contractor to receive initial payment for the work from the homeowner, then receive subsequent payment from his insurance company to repair and correct deficiencies in his own work. We find this interpretation was not the intent of the contractor and the insurance company when they entered into the subject contract of insurance, and the language of the policy clearly excludes this type of coverage. Rather than coverage and payment for building flaws or deficiencies, the policy instead covers damage caused by those flaws.

Id. at 326. Applying Florida public policy, the Court affirmed that there was no liability coverage under the policy for the general contractor.

Since *LaMarche*, Florida courts have uniformly ruled that it is against Florida public policy to provide coverage for defective construction under both the pre-and post-1986 CGL policy forms. *See, e.g., Sekura*, 896 So. 2d at 862 ("It is well established that as a matter of public policy, commercial liability policies, like Granada's, do not cover claims for defective or deficient workmanship") and *Aetna*

Cas. & Sur. Co. of Am. v. Deluxe Sys., Inc., of Fla., 711 So.2d 1293, 1296 (Fla. 4th DCA 1998) ("As a matter of public policy, a commercial liability insurance contract . . . does not cover claims for defective or deficient workmanship").

In *Centex Homes Corp. v. Pre-Stress Systems, Inc.*, 444 So. 2d 66, 67 (Fla. 3d DCA 1984), the court outlined the sound reasons for Florida's longstanding public policy:

> It is well established that the purpose of comprehensive liability insurance coverage is to provide protection for personal injury or property damage caused by the product only and not for the replacement or repair of the product. … The policy reasons for this result are obvious. If insurance proceeds could be used to pay for repairing and/or replacing poorly constructed products, a contractor or subcontractor could receive initial payment for its work and then receive subsequent payment from the insurance company to repair and replace it. Equally repugnant on policy grounds is the notion that the presence of insurance obviates the obligation to perform the job initially in a workmanlike manner.

Underscoring the logic of these cases is the Florida public policy interest against CGL coverage for breach of contract claims. In *Waste Corp. of America v. Genesis Ins. Co.*, 382 F. Supp .2d 1349 (S.D. Fla. 2005), the court articulated that public policy as follows:

> Deciding whether to read breach of contract coverage into the insuring agreement should be determined against the backdrop of the strong public policy against insuring such breaches. There is good reason for the general prohibition. Allowing an insured to control whether it will be covered for its act of breaching a contract places the insured in the unique posture of voluntarily choosing to do some act for which he knows an insurance company will compensate him even if he chooses wrongly. Who wouldn't buy insurance if he could

> decide whether to perform or decline to perform some act which would give him coverage for that action? Such a premise eliminates all risk to a potential insured. He could enter into a contract safe in the assumption that if he later decides to engage in an act which might be considered a breach, the insurance company will step forward to cover the consequences of his act if he was wrong; and if he was right, he still walks away with no consequence to himself. Such a practice is inimical to the entire concept of insurance.

Id. at 1354-55.

Florida's public policy, which was ignored in *JSUB*, properly places the burden of such business risks on contractors. The general contractor has a contractual obligation to supervise and inspect not only the work it performs but work performed on its behalf by subcontractors. If the general contractor properly performs its obligations under its contract with the owner, then the work is free from any defects. On the other hand, if the general contractor fails to perform his work correctly, that is a business risk that the general contractor should bear, as it is in the best position to stop faulty workmanship when it either rejects or accepts the subcontractor's work. *Tucker Constr. Co. v. Michigan Mut. Ins. Co.*, 423 So.2d 525, 528 (Fla. 5th DCA 1982) (the work of the subcontractor becomes the work of the general contractor's work once the subcontractor's work is completed and accepted by the general contractor).

The policy reasons for these decisions are obvious. First, if insurance proceeds could be used to pay for repairing and/or replacing poorly constructed work, a contractor could receive initial payment for its work and then receive

subsequent payment from the insurance company to repair and replace its defective work. *Centex,* 444 So.2d at 68; *LaMarche,* 390 So. 2d at 326 ("to interpret the policies providing coverage for construction deficiencies . . . would enable a contractor to receive initial payment for the work from the homeowner, then receive subsequent payment from his insurance company to repair and correct deficiencies in his own work").

Second, the presence of insurance would remove any motivation on the part of contractors to perform their work correctly in the first place. In other words, it would promote a culture of interested carelessness. If CGL policies, such as the one issued by U.S. Fire, cover all faulty workmanship, builders would have little incentive to hire competent contractors, utilize proper materials and workmanship or adhere to the architectural and contract documents. Cheaper materials and unqualified labor would ensure higher profit. Once the homeowner discovers the inevitable damages caused by these shortcuts, according to *JSUB*, the CGL insurer would be required to step into the shoes of the contractor and deliver the home as contracted, while the builder would pocket the extra profit. Under *JSUB's* approach, a general contractor would have an incentive to cut corners because there is no personal exposure, a danger that this Court avoided in *LaMarche. Centex,* 444 So.2d at 67. For this reason, shifting the burden to pay for a contractor's defective work to a CGL insurer is contrary to Florida's public policy.

This is not to say that the Policies never provide coverage. If the insured's defective work causes injury outside the contract or to third persons, "an occurrence of harm arises which is the proper subject of risk sharing as provided by the type of policy before us in this case." *LaMarche,* at 326, 27 citing *Weedo;* 405 A.2d at 791, 92. Damages to third parties as in *CTC*, or damage to property outside of the contractual obligations of the insured -- as were part of the damages here -- are covered by CGL policies. That is why U.S. Fire acknowledged that certain damages were covered. However, the economic costs an insured sustains in repairing or replacing its defective work because it breached its contractual obligations to deliver quality work or product are not covered by a CGL policy.

In *Pozzi Window Co. v. Auto Owners Ins.*, 2006 WL 1009341 (11th Cir. 2006), the Eleventh Circuit recently considered the question of coverage for defective construction in the face of Florida public policy. That case involved an insured general contractor who was alleged to have defectively installed windows. The court turned to the public policy first articulated in *LaMarche.* In analyzing Florida law, with the sole exception of *JSUB*, the *Pozzi* court observed that courts have uniformly held that coverage does not exist under the standard CGL policy for the repair or replacement of defective work. The *Pozzi* court wrote:

> However, in each case cited above, the courts nevertheless went beyond the language of the particular policies in issue and reaffirmed the *LaMarche* holding that repair or replacement costs for defective work are not the type of costs covered by CGL policies generally.

> Further, at least one of those cases, the district court's decision in *Travelers*, 227 F.Supp.2d at 1263, involves policy language identical to the Policies here and similar factual circumstances.

Simply stated, Florida's public policy does not allow for a CGL policy to provide insurance coverage for faulty workmanship. So, even if the 1986 revisions were designed to broaden coverage – as *JSUB* wrongly concluded – those revisions cannot conflict with Florida's public policy. This Court has held that "[a] contract that contravenes an established interest of society can be found to be void as against public policy." *Chandris, S.A. v. Yanakakis*, 668 So. 2d 180, 185 (Fla. 1995); *see generally, Vacation Beach, Inc. v. Charles Boyd Construction, Inc.*, 906 So.2d 374 (Fla. 5th DCA 2005) ("Contracts transgressing public policy . . . will not generally be enforced by the courts").

CONCLUSION

For the foregoing reasons, this Court should overrule *JSUB*, reaffirm the vitality of *LaMarche* and the last forty years of precedent by the First, Third, Fourth and Fifth District Courts of Appeal and find that U.S. Fire owes no coverage obligations to First Home for the costs of repairing its own defective work. U.S. Fire must not be forced to guaranty or fulfill First Home's contractual obligation to build defect-free homes.

	Respectfully submitted, *Attorneys for Petitioner,* *United States Fire Insurance Company* By:___________________________
ADORNO & YOSS LLP Joseph R. Miele, Jr. Fla. Bar. No. 0426636 350 East Las Olas Blvd. Suite 1700 Fort Lauderdale, FL 33301	HINSHAW & CULBERTSON LLP Ronald L. Kammer Fla. Bar No. 360589 Valerie M. Jackson Florida Bar No. 170135 Sina Bahadoran Florida Bar No. 523364 9155 S. Dadeland Blvd., Suite 1600 Miami, FL 33156
FOWLER WHITE BURNETT P.A. June Galkoski Hoffman Fla. Bar No. 050120 1395 Brickell Avenue, 14th Floor Miami, Florida 33131-3302 Telephone: 305-789-9200 Facsimile: 305-789-9201	EDWARDS ANGELL PALMER & DODGE LLP Donna M. Greenspan Florida Bar No. 059110 One North Clematis Street Suite 400 West Palm Beach, FL 33401

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy hereof has been furnished by U.S. Mail on this 1st day of June, 2006 to: *Counsel for Respondent,* Mark A. Boyle, Esq., Fink Boyle, P.A., 2030 McGregor Blvd., Fort Myers, Florida 33902.

____

Sina Bahadoran

CERTIFICATE OF COMPLIANCE

I HEREBY CERTIFY that this brief complies with the font requirements of Rule 9.210(a)(2) of the Florida Rules of Appellate Procedure.

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Sina Bahadoran