Every Word Counts:
In interpreting insurance policies, the language is key

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In "My Fair Lady[,]" Professor Higgins lamented, "Why Can't the English Learn How to Speak?" On behalf of the insureds and their attorneys, this plea may well be paraphrased to, "Why Can't the Companies Learn How to Write?" Why is it that so many of them insist upon cluttering up their policies with braintesting definitions, exclusions and conditions? Why do they compound the error by scattering their provisions and clauses with equally baffling phrases such as "unless as a condition precedent thereto"; "but only if"; "notwithstanding anything to the contrary"; "except with respect to" – naming just a few? For years they have insisted upon inserting ambiguity and repugnancy in their policies, to the consternation of laymen and attorneys alike, all in face of the fact that when they indulge in such practice, the courts invariably construe the policies liberally in favor of the insured and against the insurer. In fact, these days, the mere mention of the provisions of an insurance policy is looked upon as a not-so-funny joke.

– Judge Gobbie, *Fontainebleau Hotel Corp. v. United Filigree Corp.*, 298 So. 2d 455, 458 (Fla. 3d DCA 1974).

> "When I use a word," Humpty Dumpty said, in a rather scornful tone, "it means just what I choose it to mean – neither more nor less."
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> "The question is," said Alice, "whether you can make words mean so many different things."
>
> "The question is," said Humpty Dumpty, "which is to be master – that's all."

– Lewis Carroll, *Alice's Adventures in Wonderland* (1865).

This article focuses on the most significant insurance-law decisions from the state and federal courts in the past year, and spotlights the policy language and the statutes that control the outcomes. It is not hyperbole to say that every word in an insurance policy matters – a truism that, at the very least, lurks beneath the surface of every coverage case and that, we hope, is illuminated by a close study of the decisions discussed below. In the words of the Florida Supreme Court, "[I]n interpreting policies, the language is key." *Taurus Holdings, Inc. v. U.S. Fid. & Guar. Co.,* 913 So. 2d 528, 535 (Fla. 2005).

I. MAJOR NEW FLORIDA CASE LAW

A. Florida Rules of Policy Interpretation

When reading the cases that follow, and when examining the insurance policy in question, one must bear in mind the rules Florida courts apply when undertaking a similar task. In Florida, courts are required to construe an insurance policy in accordance with its plain language, *Taurus,* 913 So. 2d at 532; that is, its "everyday 'man-on-the-street' understood meaning," *Goldstein v. Paul Revere Life Ins. Co.,* 164 So. 2d 576, 578 (Fla. 4th DCA 1964). Further, the policy should be read as a whole, with the court

endeavoring to give every provision its full meaning and operative effect. *Auto-Owners Ins. Co. v. Anderson*, 756 So. 2d 29, 34 (Fla. 2000).

If the relevant policy language is susceptible to more than one reasonable interpretation, one providing coverage and one limiting coverage, the policy is ambiguous. *Id.* Ambiguous policy provisions are interpreted liberally in favor of the insured and strictly against the drafter who prepared the policy. *Id.* To establish that a policy term is ambiguous, the putative insured needs to show neither that her interpretation is correct nor that the insurer's interpretation is unreasonable; she must merely demonstrate that the insurer's interpretation is not the only reasonable interpretation; i.e., there exists an alternative interpretation that is not unreasonable. *Continental Ins. Co. v. Roberts,* 410 F.3d 1331, 1333 (11th Cir. 2005). The fact that courts have disagreed over the interpretation of a term is enough to demonstrate that the term is ambiguous. *Security Ins. Co. of Hartford v. Investors Diversified Ltd., Inc.*, 407 So. 2d 314, 316 (Fla. 4th DCA 1981).

In determining whether policy language is ambiguous, Florida courts also consider whether clearer language was available that the insurer could have used to remove the interpretive problem. *Anderson,* 756 So. 2d at 36. Exclusions in policies are construed even more strictly than coverage clauses against the insurer. *Id.*

Justice Drew, in *Hartnett v. Southern Ins. Co.,* 181 So. 2d 524 (Fla. 1965), explained the rationale for Florida's approach to policy interpretation:

> There is no reason why [insurance] policies cannot be phrased so that the average person can clearly understand what he is buying. And so long as these contracts are drawn in such a manner that it requires the proverbial Philadelphia lawyer to comprehend the terms embodied in it, the courts should and will construe them liberally in favor of the insured and strictly against the insurer to protect the buying public who rely upon the companies and agencies in such transactions.

Hartnett, 181 So. 2d at 528.

B. *Castillo* – The Third DCA uses State Farm's Internal Operating Guidelines as evidence of coverage

In *Castillo v. State Farm Florida Insurance Co*., 971 So. 2d 820 (Fla. 3d DCA 2007), the dispute was over State Farm's denial of coverage under a homeowner's policy as a result of earth movement. The real significance of the Third District Court of Appeal's opinion, however, lies in its use of internal State Farm operating guidelines as an interpretive tool that can impart meaning onto ambiguous policy terms.

At issue were Castillo's allegations that vibration and shockwaves caused by blasting and without displacement of the earth resulted in damage to their insured dwelling. *Id.* at 821. State Farm raised the "Earth Movement" exclusion as a bar to coverage, which read as follows:

> b. Earth Movement, meaning the sinking, rising, shifting, expanding, or contracting of earth, all whether combined

> with water or not. Earth movement includes but is not limited to earthquake, landslide, mudflow, sinkhole, subsidence and erosion…

Id. The policyholder argued that the exclusion was ambiguous and should be narrowly construed against the insurer because the exclusion did not specifically address whether damages by blasting, shockwaves, or vibrations categorically fall under "earth movement."

The court agreed with the policyholder, and held the exclusion to be ambiguous. *Id.* at 822-23. As a result, the court declared it would consider parol evidence to explain the ambiguity. In doing so, the court examined State Farm's internal operating guideline OG 75-105, which contemplated vibrations and shockwaves, as alleged by Castillo, to be a covered loss:

> By interpretation, coverage will be provided for damage as a result of shockwaves being transmitted through the earth so long as there is no permanent displacement of the earth itself…. Blasting that causes shockwaves/vibration to be transmitted through the earth to the insured dwelling and which shockwaves damage the dwelling without displacement of the earth would be considered a covered loss.

Id. at 823. The court then notes that by its own guidelines, "State Farm envisioned possible scenarios where shockwaves and vibrations caused by blasting may result in damage to an insured dwelling without displacement of the earth," and acknowledges that such a loss would be covered. *Id.*

The implications of the court's analysis are not difficult to recognize.

Insurers often resist pretrial discovery of such internal operating guidelines in a coverage case as irrelevant. Going forward, a policyholder seeking discovery of similar materials can point to *Castillo* as an instance where internal insurer materials were used to illuminate ambiguous provisions of the policy, and even persuade the court that similar manuals may be used against the insurer where coverage is in dispute.

C. *J.S.U.B.* – The importance of the standard form and clarification of CGL coverage related to defective workmanship of a subcontractor

One of the more highly anticipated decisions by construction subcontractors seeking coverage for defects in their work was handed down by the Florida Supreme Court in *United States Fire Insurance Co. v. J.S.U.B., Inc.*, No. SC05-1295, 2007 WL 4440232 (Fla. Dec. 20, 2007). J.S.U.B. and Logue Enterprises contracted to build several homes in the Lehigh Acres area of Lee County. After completion and delivery of several homes to the homeowners, damage to the foundations, drywall, and other interior portions of the homes became visible. The damage was caused entirely by the use of poor soil by subcontractors and improper soil compaction and testing. The homeowners brought suit against J.S.U.B., demanding that the damage be repaired or remedied, asserting claims for breach of contract, breach of warranty, negligence, strict liability, and

violation of the Florida Building Code. *Id.* at *1-2.

J.S.U.B was insured under a commercial general liability (CGL) policy and renewal policy issued by U.S. Fire. The policies provided occurrence-based coverage for "bodily injury" or "property damage," as well as coverage for "products completed operations hazard," which 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 . . . work that has not been completed or abandoned.

Id. at *2. Of the numerous exclusions found in the policies, two were particularly relevant:

> j. Damage To Property
>
> "Property damage" to:
>
> . . . .
>
> (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly 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.
>
> . . . .
>
> <u>Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard</u>."

. . . .

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.

Id. (emphasis in original).

U.S Fire agreed with J.S.U.B. that the policies provided coverage for damage to the personal property of the homeowners, but maintained that no coverage existed for the costs of repairing the structural damage to the homes, including damage to foundations and drywall. *Id.* The Florida Supreme Court distilled the issue as:

> whether a post-1986 standard form commercial general liability policy with products-completed operations hazard coverage, issued to a general contractor, provides coverage when a claim is made against the contractor for damage to the completed project caused by a subcontractor's defective work.

Id. at *3. Ultimately, the court answered this question in the affirmative. *Id.* at *1.

In doing so, the court undertook an exhaustive review of the history

and evolution of CGL policies, an evolution due in part to the gradual expansion through the years of the insuring agreement contained in such policies and the narrowing of the exclusions, particularly the so-called "business risk" exclusions that historically have been interpreted to bar coverage for similar claims. *Id.* at *6-9. *See LaMarche v. Shelby Mut. Ins. Co.*, 390 So. 2d 325 (Fla. 1980) (generally cited for the proposition that CGL policies do not provide coverage for damage to the contractor's work caused by faulty workmanship). The court was forced to thoroughly examine its decision in *LaMarche*, ultimately finding that its decision was based on the policy exclusions, not the insuring provisions, despite its broad proclamations[2] regarding the purpose of CGL policies. *Id.* at *6.

More significantly, the court made a key distinction between the policy language of pre-1986 CGL policies (similar to the one at issue in *LaMarche*) and post-1986 CGL policies, which added the exceptions to exclusions (j) and (l) of the standard policy that are found in the policy issued to J.S.U.B. by U.S. Fire. The court found that the holdings and reasoning of cases interpreting the pre-1986 standard policy (including *LaMarche* and the

[2] The *LaMarche* court, in noting the consistency of its holding with other jurisdictions, stated that "the purpose of this comprehensive liability insurance 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." *LaMarche*, 390 So. 2d at 326.

seminal New Jersey case of *Weedo v. Stone E. Brick, Inc.*, 405 A.2d 788, 792 (N.J. 1979)) were not binding on its analysis of a post-1986 policy, noting that "the role of precedent in insurance policy interpretation cases depends largely on whether the underlying facts and the policies at issue in the two decisions are similar." *Id.* at *9.

Therefore, it was necessary for the court to analyze the two main coverage issues at the heart of the case: (i) whether faulty workmanship can constitute an "occurrence" as defined in the policy, and (ii) whether the subcontractors' improper soil preparation caused property damage.

1. Is faulty workmanship an "occurrence"?

The policies at issue defined "occurrence" as an "accident," but left "accident" undefined. In *State Farm Fire & Casualty Co. v. CTC Development Corp.*, 720 So. 2d 1072 (Fla. 1998), the court held that policies that left "accident" undefined provided coverage not only for accidental events, but also injuries or damage neither expected nor intended from the standpoint of the policyholder. *Id.* at 1076. U.S. Fire argued that the faulty workmanship of a subcontractor that damages the contractor's own work can never be an "accident" because it would result in reasonably foreseeable damages. *J.S.U.B.*, 2007 WL 440232 at *9. In the court's view, such an interpretation would make the definition of "occurrence" dependent on which

property was damaged – a result that was untenable. *Id.*

Similarly, U.S. Fire's argument that a breach of contract can never result in an "accident" was not supported by the plain language of the policies. *Id.* at *10. *See American Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65, 83 (Wisc. 2004); *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 491 (Kan. 2006). Moreover, the court found significant the fact that the Insurance Services Office, which drafts many of the "standard" forms and policy provisions used in the insurance industry, had begun to issue an endorsement that may be included in a CGL policy and eliminates the subcontractor exception to the "your work" exclusion. Had U.S. Fire intended to eliminate such language, it could have done so, the court reasoned. *J.S.U.B.*, at *10.

The court ultimately held that faulty workmanship that is neither intended or expected from the standpoint of a contractor can constitute an "accident," and, therefore, an "occurrence" under a post-1986 CGL policy, and that the defective soil preparation at issue was an "occurrence." *Id.* at *14.

2. *Did the subcontractor's improper soil preparation constitute "property damage"?*

To determine whether the policies in fact provided coverage, the court

was forced to examine whether the "occurrence" caused "property damage" within the meaning of the policies. In concluding that physical injury to the completed project that occurs as a result of defective work can constitute "property damage," the court began its analysis with the language of the applicable policies.

The CGL policies defined "property damage" as "physical injury to tangible property, including all resulting loss of use of that property." *Id.* The court took note that this definition does not differentiate between damage to the contractor's work and damage to other property, just like the definition of "occurrence." Moreover, the court recognized the distinction between (1) defective work or faulty workmanship that has damaged the otherwise non-defective completed project, which plainly causes "physical injury to tangible property," and (2) defective work or faulty workmanship that causes no ancillary damage, which does not cause "physical injury to tangible property." *Id.* This distinction is hugely important in construction defect cases, as is illustrated by *J.S.U.B.*'s companion case, *Auto Owners Insurance Co. v. Pozzi Window Co.*, No. SC06-779, 2007 WL 4440389 (Fla. Dec. 20, 2007), which is discussed in detail below.

The *J.S.U.B.* court held that the defective soil preparation resulted in a "claim for repairing the structural damage to the completed homes caused by

the subcontractor's defective work" and not a claim for the cost of repairing the subcontractor's defective work itself. *Id.* at *15. In doing so, the court found public policy arguments advanced by U.S. Fire unpersuasive, including that indemnity would create a windfall for contractors and would give contractors less incentive to be diligent in scrutinizing the work of their subcontractors. *Id.*

D. *Pozzi* – No coverage under CGL policy for replacement of defective work

As noted above, the case of *Auto-Owners Insurance Co. v. Pozzi Window Co.*, No. SC06-779, 2007 WL 4440389 (Fla. Dec. 20, 2007), highlights the critical distinction between an insurer's liability for repair and replacement costs of the defective work of a subcontractor, on the one hand, as opposed to the insurer's liability for repair and replacement costs of damage to insured property resulting from the subcontractor's defective work, on the other.

The case is similar factually to *J.S.U.B.*, with one important difference that was outcome determinative. A builder constructed a multimillion-dollar home in Coconut Grove that included windows manufactured by Pozzi Window Co. and installed by the builder's subcontractor. Once the house was completed, the owner complained of water leakage around the windows

caused by defective installation of the windows, and brought suit against the builder, the subcontractor that installed the windows, and Pozzi. *Id.* at *1.

Auto-Owners had issued two identical occurrence-based CGL policies to the builder, which contained a coverage grant similar to that in the policies at issue in *J.S.U.B.,* and included "products-completed operation hazard" coverage that "[i]ncludes all 'bodily injury' and 'property damage' occurring away from premises you own or rent and arising out of 'your product' or 'your work' except . . . work that has not yet been completed or abandoned." *Id.* at *2. The policies also contained exclusions (j) and (l), phrased similarly to the exclusions at issue in *J.S.U.B.* and containing exceptions dealing with the products-completed operations hazard and work performed by a subcontractor on the contractor's behalf. *Id.*

Auto-Owners paid the homeowner for personal property damage caused by the leaking windows, but denied coverage for the cost to repair or replace the windows themselves. The Florida Supreme Court reviewed the case as a certified question from the Eleventh Circuit, distilling the issue as whether a post-1986, standard-form CGL policy with products-completed operations hazard coverage, issued to a general contractor, provides coverage for the repair and replacement of a subcontractor's work. *Id.* at *3.

The court first addressed the issue by reviewing its decision in

J.S.U.B., and setting the discrete issue before it in *Pozzi* against *J.S.U.B.*'s analytical backdrop, being careful to note the difference. The court found the analysis of the definition of "occurrence" to be controlled by *J.S.U.B.*, but found analysis of "property damage" to be dispositive. Unlike *J.S.U.B.*, which involved a claim for the cost to repair structural damage to homes caused by the defective work of a subcontractor, *Pozzi* involved a claim for the costs to repair or replace the defectively installed windows. The court held, consistent with its analysis and *J.S.U.B.*, that as the "subcontractor's defective installation of the windows is not itself 'physical damage to tangible property,' there is no 'property damage' under the terms of the CGL policies." *Id.* at *5. Accordingly, no coverage existed for the costs of repair and replacement of the defective work. *Id.*

E. *Cox* – The Valued Policy Law speaks to valuation, not causation

Of several major cases dealing with Florida's Valued Policy Law ("VPL"), *Florida Farm Bureau Casualty Insurance Co. v. Cox*, 967 So. 2d 815 (Fla. 2007), is perhaps the most important. The Florida Supreme Court addressed the issue of whether the 2004 version of the VPL, Section 627.702(1) of the Florida Statutes, requires a carrier to pay the face amount of the policy to an owner of a building deemed a total loss when the building

suffers damage from a covered peril as well as an excluded peril. In holding that the VPL did not require such payments, the court significantly eroded the case of *Mierzwa v. Florida Windstorm Underwriting Association*, 877 So. 2d 774 (Fla. 4th DCA 2004), a decidedly pro-policyholder case that held that if an insurer has <u>any</u> liability for a total loss, then the VPL requires that the insurer pay the policy limits.

The 2004 version[3] of the VPL at issue in *Cox* reads as follows:

> (1) In the event of the total loss of any building, structure, mobile home as defined in s. 320.01(2), or manufactured building as defined in s. 553.36(12), located in this state and insured by any insurer as to a covered peril, in the absence of any change increasing the risk without the insurer's consent and in the absence of fraudulent or criminal fault on the part of the insured or one acting in her or his behalf, the insurer's liability, if any, under the policy for such total loss shall be in the amount of money for which such property was so insured as specified in the policy and for which a premium has been charged and paid.

§ 627.702(1), Fla. Stat. (2004). The policyholders' home was deemed a total loss following Hurricane Ivan, having suffered both wind and flood damage. Their homeowners' policy with Florida Farm Bureau was valued at $65,000, and provided protection from losses caused by wind damage but did not

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[3] Following *Mierzwa's* release, the Florida Legislature amended the VPL by expressly providing that "when a loss was caused in part by a covered peril and in part by a noncovered peril, paragraph (a) does not apply. In such circumstances, the insurer's liability under this section shall be limited to the amount of the loss caused by the covered peril." § 627.702(1)(b), Fla. Stat. (2005).

include losses based on flood damage. Florida Farm Bureau argued that it was not liable for the total loss of the home because the covered peril (wind damage) caused only $11,583.93 of the damage to the home; the remaining loss was caused by flood damage and storm surge, which were expressly excluded perils. The policyholder, not surprisingly, argued that, based on *Mierzwa,* the VPL required Florida Farm Bureau to pay the full face value of the policy because the home was damaged by a covered peril. *Cox*, 967 So. 2d at 817-18.

The Florida Supreme Court began its analysis by examining the legislative history of the VPL, and noting that a plain reading of the 2004 version shows that the statute was intended to "only set the value of the property insured by the policy in order to conclusively establish the property's value when there is a total loss." *Id.* at 818. This interpretation was in accord with Judge Polston's dissent in *Cox* in the First District, which was expressly adopted by the Supreme Court's opinion, and stated:

> Instead of treating the VPL as only a valuation statute . . . the majority aligns this court with . . . *Mierzwa* by reading into the statute a requirement for the insurer to pay for damages caused by both excluded and covered perils. "Causation" is not mentioned in the statute. Because it is not mentioned, the statute has no application other than to conclusively establish the property's value when there is a total loss. Therefore, the unambiguous terms of the policy must be given effect.

Florida Farm Bureau Ins. Co. v. Cox, 943 So. 2d 823 (Fla. 1st DCA 2006) (Polston, J., dissenting). The beginning phrase of the statute states: "In the event of the total loss . . . as to a covered peril . . . the insurer's liability, if any, under the policy for such total loss shall be in the amount of money for which such property was so insured as specified in the policy and for which a premium has been charged and paid." *See Cox*, 967 So. 2d at 820. In the court's view, such language is evidence that the Legislature did not intend to tamper with the terms of the insurance policy. *Id.*

Moreover, the court expressly disapproved *Mierzwa*, noting that the cases were factually similar in that each policyholder's property was damaged by a combination of wind and water in a hurricane, and the insurer asserted that it was responsible for the percentage of total loss attributed to wind, but did not contest the total value of the property. *Mierzwa's* holding that "if the insurance carrier has any liability at all to the owner for a building damaged by a covered peril and deemed a total loss, that liability is for the face amount of the policy" fails to give effect to all provisions of the VPL statute. *Id.* at 821. The court did, however, expressly limit its holding to "only those cases in which a covered peril did not cause a total loss or constructive total loss." *Id.* at 821, n.6.

It must be kept in mind that *Cox* deals with a version of the VPL that is

no longer on the books, and will apply only to open cases from the 2004 hurricane season where either total or constructive total losses resulted from a combination of wind and flood.

F. *Ceballo* – The VPL has no applicability to supplemental coverages

Another important case addressing the VPL is *Ceballo v. Citizens Property Insurance Corp.*, 967 So. 2d 811 (Fla. 2007). The Ceballos lost their home to fire, a covered peril under their policy with Citizens. The home was declared a total loss, and Citizens paid the face value of the policy. However, the policy also contained a supplemental "Ordinance or Law" provision.[4] The parties agreed that the Ceballos were entitled to recovery under the Ordinance or Law provision; they disputed whether a policyholder

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[4] The supplemental coverage read as follows:

11. Ordinance or Law

> a. You may use up to twenty-five percent (25%) of the limit of liability that apples to COVERAGE A for the increase (sic) costs you incur due to the enforcement of any ordinance or law which requires or regulates:
>
> > (1) The construction, demolition, remodeling, renovation or repair of that part of a covered building or other structure damaged by a PERIL INSURED AGAINST; or
> >
> > (2) The demolition and reconstruction of the undamaged part of a covered building or other structure, when that building or other structure must be totally demolished because of damage by a PERIL INSURED AGAINST to another part of that covered building or other structure; or
> >
> > (3) The remodeling removal or replacement of the protion of the undamaged part of a covered building or other structure necessary to complete the remodeling, repair or replacement of that part of the covered building or other structure damaged by a PERIL INSURED AGAINST.

Ceballo, 967 So. 2d at 812.

was first required to show proof of an actual loss in order to recover under the provision. The Ceballos argued that because they had met the burden of demonstrating a total loss under the VPL, they should receive the policy limits of the supplemental coverage without having to establish that they actually had incurred any additional loss or expense. *Id.* at 812-13. In other words, was the policyholder entitled to automatic recovery of the policy limits of the supplemental coverage simply by meeting the requirements of the VPL, but without demonstrating that a specific loss was incurred beyond the loss of the home?

The Florida Supreme Court ultimately said no, and held that the VPL does not override the language of a policy as it relates to supplemental coverages, disapproving any conflicting language in *Mierzwa*. *Id.* at 812. In doing so, the court noted that where the supplemental coverage provisions of the policy did not state a dollar amount, but instead only the maximum percentage of the limit of liability, the VPL does not apply. *Id.* at 814. The VPL requires that the policy designate an actual dollar amount as the value of the structure so as to remove any uncertainty as to what the policyholder is entitled to recover for a total loss – a purpose that bears no relation to supplemental coverages offered by an insurer. *Id.* This rationale is bolstered by the oft-cited requirement that an insurer's liability for replacement cost

does not arise until the repair or replacement has been completed and the policyholder actually has expended some sum to repair, replace, or rebuild. *Id*. at 815.

Therefore, the Ceballos were entitled to the face value of their policy for the total loss of their home, but that loss does not affect their obligation to show that they have incurred an additional loss in order to recover under the supplemental "Ordinance or Law" coverage. *Id.* The VPL does not mandate the payment of policy limits of the "Ordinance or Law" coverage without proof of loss where the unambiguous language of the policy requires such proof. *Id.*

G. *Garcia* – Narrowing coverage for additional insureds

The case of *Garcia v. Federal Insurance Co*., 969 So. 2d 288 (Fla. 2007) is a cautionary tale on how policy language affects the coverage available to an additional insured. As part of her duties as a caregiver, Maria Garcia ran errands in a Volvo owned by her elderly employer's son-in-law. One day as she was driving the Volvo in a supermarket parking lot, her foot slipped off the brake pedal, causing the car to strike and seriously injure a pedestrian who was withdrawing cash from a nearby ATM. The pedestrian sued the owner of the Volvo, Garcia's boss, and Garcia, alleging that each was independently negligent for allowing the brake pedal to wear down to the

point that bare metal was all that remained. *Id.* at 289-90.

Garcia's employer was covered by a homeowner's policy issued by Federal, which defined "covered person" as:

> [1] You or a family member;
>
> [2] any other person or organization with respect to liability because of acts or omissions of you or a family member; or
>
> [3] any combination of the above.

Id. at 290. Garcia argued that she qualified as "any other person or organization with respect to liability because of acts or omissions" of her employer. Federal denied her claim, arguing that the policy's additional insured clause covers only those individuals who become vicariously liable for the acts of omissions of the named insured, and because Garcia was sued for her own negligent acts, not for any acts or omissions of her boss, she did not qualify as an additional insured. *Id.*

On review of certified questions from the Eleventh Circuit, the Florida Supreme Court agreed with Federal. In the court's view, the issue before it was whether a clause covering "any other person with respect to liability because of acts or omissions" of the named insured covers only vicarious liability for the negligence of the named insured. *Id.* at 291. Ultimately the court held that the above phrase is unambiguous and limits an additional

insured's coverage to instances of vicarious liability. *Id.*

In doing so, the court noted that the phrase "with respect to" essentially means "concerning," and that the phrase "because of" is equivalent to "by reason of." Therefore, when considered in context, the policy means that an additional insured is entitled to coverage only "*concerning* liability that is *caused by* or occurs *by reason of* acts or omissions of the named insured." *Id.* at 292 (emphasis in original). The court also examined other cases[5] interpreting similar language, which dealt with additional insured clauses containing the phrase "but only" – a difference that Garcia argued rendered her policy language ambiguous. The court found for Federal on this point, noting the significance of "because of." The omission of the phrase "but only" did not materially change the limitation of the additional insured provision to instances of vicarious liability. *Id.* at 292-93. The court also noted that cases interpreting the phrase "arising out of," such as *Taurus Holdings, Inc. v. U.S. Fidelity & Guaranty Co.*, 913 So. 2d 528 (Fla. 2005), do not apply to the interpretation of the Federal additional insured provision because "arising out of" is broader than the language in

[5] *See Consolidation Coal Co. v. Liberty Mut. Ins. Co.*, 406 F. Supp. 1292 (W.D. Pa. 1976); *Vulcan Materials Co. v. Casualty Ins. Co.*, 723 F. Supp. 1263 (N.D. Ill. 1989); *Sprouse v. Kall*, 2004-Ohio-353, 2004 WL 170451 (Ohio Ct. App. Jan. 29, 2004); *Transportation Ins. Co. v. George E. Failing Co.*, 691 S.W. 2d 71, 73 (Tex. App. 1985).

Federal's clause. "Arising out of" contemplates a more attenuated causal link than "because of." *Garcia*, 969 So. 2d at 293.

H. ***Progressive Plumbing – Shapiro*'s choice of law doctrine is on life support in the wake of *Roach***

When a coverage dispute reaches the litigation stage, one of the first determinations to be made by coverage counsel relates to choice of law – that is, the determination of which jurisdiction's law will apply to the interpretation of the insurance policy. Since 1990, this question has largely been governed by the Eleventh Circuit's decision in *Shapiro v. Associated International Insurance Co.*, 899 F.2d 1116 (11th Cir. 1990), which held that the law to be applied to insurance contracts that do not concern automobiles is the local law of the state that the parties understood to be the principal location of the insured risk. For example, even if a CGL policy that was meant to insure a construction project situated in Georgia was issued to a Florida corporation with headquarters and a principal place of business in Florida, Georgia law would apply to the interpretation of the CGL policy.

In 2006, the Florida Supreme Court decided *State Farm Mutual Auto Insurance Co. v. Roach*, 945 So. 2d 1160 (Fla. 2006), in which the court bolstered the applicability of the choice of law doctrine *lex loci contractus*, which, when applied to contracts of insurance, provides that, "the law of the

jurisdiction where the contract was executed governs the rights and liabilities of the parties in determining an issue of insurance coverage." *Id.* at 1163. This is because "when the parties come to terms in an agreement, they do so with the implied acknowledgment that the laws of that jurisdiction will control, absent some provision to the contrary." *Sturiano v. Brooks*, 523 So. 2d 1126, 1129 (Fla. 1988).

Roach involved two Florida snowbirds who were homesteaded in Indiana, where they bought automobile policies covering their cars. While they were spending the winter in Florida, one of the cars was involved in an accident, killing a passenger. Following an exhaustive analysis, the Florida Supreme Court held that Indiana law applied to the ensuing coverage dispute, as the policies were executed and delivered in Indiana. *Roach*, 945 So. 2d at 1169. However, the court did so without mention of or citation to *Shapiro*, seemingly leaving its vitality in limbo.

Any uncertainty was, at least for the time being and at least for federal-court litigants, put to rest by the Middle District of Florida in *Valiant Insurance Co. v. Progressive Plumbing, Inc.*, No. 5:06-CV-410-OC-10GRJ, 2007 WL 2936241 (M.D. Fla., Oct. 9, 2007). The case involved a CGL policy issued by Valiant that was executed in Florida through a Florida insurance agent and issued to a Florida corporation with its principal place of

business in Florida, but insured against losses to a construction project in Georgia. Valiant moved to dismiss a declaratory judgment action filed by the policyholder, arguing that Georgia law should apply to the coverage dispute based on *Shapiro*. *Id.* at *1-2.

Judge Hodges of the Middle District found for the policyholder, holding that Florida law applied. *Id.* at *4. In doing so, he examined both *Shapiro* and *Roach*, noting that *Shapiro* was little more than an *Erie*-based guess as to the nature of Florida law at the time and that the Florida Supreme Court's decision in *Roach* made clear that *lex loci contractus* remained the controlling doctrine in Florida. Although the *Roach* court neither cited to nor mentioned *Shapiro*, Judge Hodges based his decision on the following broad proclamation in *Roach*: "We have never retreated from our adherence to this rule in determining which state's law applies to interpreting contracts." *Id.* at *3 (quoting *Roach*, 945 So. 2d at 1164).

While Judge Hodges may have cleared up any immediate uncertainty as to the application of *Roach* outside of automobile insurance, the issues raised by his opinion in *Progressive Plumbing* are extremely important for any company that carries insurance for risks situated out of state. It is likely we have not seen the last of this issue, as the Eleventh Circuit, and eventually the Florida Supreme Court, will surely have another opportunity to weigh in.

I. New case law relating to Uninsured Motorist (UM), Underinsured Motorist (UIM) and umbrella automobile policies

1. Peraza *–Waiver of settlement offer*

The case of *Peraza v. Robles*, No. 3D06-725, 2007 WL 2043435 (Fla. 3d DCA, July 18, 2007) is a cautionary tale for policyholders and those handling their UM claims. Peraza was involved in a car wreck caused by Robles. Peraza's counsel sent Robles's liability carrier a bad faith letter demanding it pay the $10,000 policy limits within 15 days. A $10,000 draft from Robles's claims adjuster was forwarded to Peraza's counsel. Peraza's counsel did not negotiate the draft, but instead filed suit, which resulted in a final order enforcing the $10,000 settlement. *Id.* at *1.

Peraza appealed, contending that the terms of the offer (i.e., the letter sent by the claims adjuster accompanied by the settlement check) were not met, in that a release from her UM carrier was not secured until Robles's liability carrier received an unaltered release, along with a copy of the UM Carrier Authorization of Settlement and Waiver of Subrogation Rights. *Id.*

The court held that the "term" was plainly one that would have benefitted only the insurer and its insured in precluding a potential subrogation action against them, and found that the term was waived. Therefore, because Peraza received the policy limits she "demanded," no bad

faith action for any amount beyond the $10,000 settlement may be maintained; a result with which the court was "not uncomfortable." *Id.*

2. Shaw – *Effect of changes to UM coverage on subsequent recovery*

In *State Farm Mutual Automobile Insurance Co. v. Shaw*, 967 So. 2d 1011 (Fla. 1st DCA 2007), the policyholders, a newlywed couple, were struck and killed in a head-on collision involving an uninsured motorist. The accident occurred while the couple was in a truck owned by the wife, which was insured by a carrier other than State Farm that did not have UM coverage. The tortfeasor's insurance policy tendered the policy limits to the deceased, and the estates of the deceased filed a claim seeking UM benefits under the husband's State Farm policy, which had liability limits of $100,000/$300,000 and UM benefits of $50,000/$100,000, as well as comprehensive collision coverage. Those limits were the result of the husband's previous wife's lowering the amount of coverage under the policy while they were still married. *Id.* at 1012-13.

State Farm denied the claim on the basis of the following exclusionary language for UM coverage found in the policy:

> There is no coverage ... for bodily injury to an insured while occupying any vehicle owned by you, your spouse, or any relative if it is not insured for this coverage under this policy. This does not apply to an insured occupying a newly acquired car which has no uninsured motor vehicle coverage applicable to

it.

Id. at 1013. The First District held that the ex-wife's election of reduced coverage remained in effect because the policy was replaced with the same bodily injury policy limits, pursuant to section 627.727(1) of the Florida Statutes, and that the husband's divorce from the previous wife did not require a new UM coverage offer from State Farm. *Shaw*, 967 So. 2d at 1015. The court also noted that changes to policies that do not affect bodily injury liability limits do not require a new UM election. *Id.* (collecting cases). The estates of the deceased argued, however, that the cumulative effect of the various changes to the policy caused the resulting policy to be a "new" policy instead of a replacement policy, but the court found no support for that argument in the language of Section 627.727(1) or in the case law. *Id.* at 1015-16.

Ultimately, the First District granted each estate additional UM benefits of $50,000 each, rather than the $100,000 each awarded provided by the trial court. *Id.* at 1016.

3. Tepper – *Improper joinder of tortfeasor in suit against UIM carrier*

In *Metropolitan Casualty Insurance Co. v. Tepper*, 969 So. 2d 403 (Fla. 5th DCA 2007), Tepper was riding his bicycle when he was hit by a

vehicle owned and operated by Lucas. Tepper subsequently filed a two-count complaint against Lucas and Metropolitan, asserting a negligence claim against Lucas, and seeking to recover uninsured/underinsured benefits from Metropolitan. The complaint alleged that Tepper had suffered serious and permanent injuries as the result of Lucas's negligence. *Id.* at 404-05.

Lucas's insurer tendered its policy limits of $25,000 to Tepper as full settlement of Tepper's claim against Lucas. Metropolitan did not give Tepper an opportunity to reject the settlement offer. Instead, Metropolitan paid Tepper $25,000 and preserved its subrogation rights against Lucas. *Id.* at 405. Tepper accepted the settlement tendered by Metropolitan, and Lucas moved to dismiss the count against him in Tepper's suit, arguing that Tepper had "constructively or actually assigned his rights against Lucas to Metropolitan" and only Metropolitan now enjoyed the right to sue Lucas. *Id.* Over Tepper's objection, the trial court granted Lucas's motion.

On appeal to the Fifth District, Metropolitan argued that the trial court's ruling conflicted with Section 627.727(6)(b), Florida Statutes (2004), which provides in relevant part:

> If an underinsured motorist insurer chooses to preserve its subrogation rights by refusing permission to settle, the underinsured motorist insurer must, within 30 days after receipt of the notice of the proposed settlement, pay to the injured party the amount of the written offer from the underinsured motorist's liability insurer. Thereafter, upon final resolution of the

> underinsured motorist claim, the underinsured motorist insurer is entitled to seek subrogation against the underinsured motorist and the liability insurer for the amounts paid to the injured party.

Metropolitan contended that the operation of this language did not extinguish Tepper's claim against Lucas, and thus the motion to dismiss should not have been granted. The court agreed, but noted that

> nothing in subsection (6)(b) required Tepper to pursue his claim against Lucas if he was willing to forego [*sic*] seeking damages in excess of the sum of $25,000 offered by Lucas (but paid by Metropolitan) and the limits of his UM policy.

Tepper, 969 So. 2d at 406. The court concluded[6] that Metropolitan could not bring a third party action against Lucas, but could seek subrogation against Lucas upon final resolution of the UIM claim as provided by Section 627.727(6)(b). *Id.* at 407.

II. LEGISLATIVE UPDATE

A. The Florida Regulatory Landscape

Although 2007 was marked by a quiet hurricane season, the Florida Legislature and the Office of Insurance Regulation (OIR) remained quite active by getting tough with insurers seeking to raise homeowner's insurance

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[6] The court also addressed Metropolitan's argument that Tepper was required to comply with the policy's cooperation clause by joining the tortfeasor in the action to recover UM/UIM benefits by noting that Tepper did just that in his initial complaint, and that he did not violate his contractual obligation by not opposing Lucas' motion to dismiss. *Tepper*, 969 So. 2d at 407-08.

premiums, instituting major changes in the mandate and scope of coverage provided by the state-created Citizens Property Insurance Corporation, and reinstating no-fault PIP coverage following a brief sunset period.

1. *The Homeowner's rate crackdown: Getting tough with Allstate and other large insurers*

In January 2007, special legislation was enacted to expand the Florida Hurricane Insurance Catastrophe Fund, making lower-cost reinsurance available to property insurers. The stated goal was to enable insurance companies to pass along savings from the reinsurance market directly to policyholders in the form of lower rates. Allstate, acting through its Florida subsidiaries, had dropped more than 300,000 customers since the hurricane season of 2005. For the 2008 policy year, the Allstate Companies sought double-digit rate increases for homeowners, on the average, across the state, with Allstate Floridian Insurance Company leading the way with a rate increase request of 43.4 percent. The Office of Insurance Regulation initially denied the proposed increases, noting that some Allstate policyholders might see increases as much as 150 percent.

As a result, Insurance Commissioner Kevin McCarthy called a special two-day hearing into Allstate's reinsurance program and issued subpoenas seeking documents relating to Allstate's relationship with risk-modeling

companies, insurance rating organizations, and insurance trade associations. Included in the subpoena was the so-called McKinsey Report, a series of documents and PowerPoint presentations prepared by the industry consulting group McKinsey & Co., which is said to shed light on how Allstate sets its rates. Allstate has been paying a $25,000 per day fine to a Missouri court (a total of more than $2.4 million as of this writing) to avoid producing the documents, which it contends relate only to auto insurance and are proprietary in nature.

On January 16, 2008, Commissioner McCarthy suspended Allstate's license to write new policies in the state until the company fully complies with the subpoenas. Existing policies were not affected. Two days later, however, the First District Court of Appeal in Tallahassee stayed the suspension pending the outcome of Allstate's appeal. Soon after, Allstate turned over some of the requested material in the hopes that it will appease regulators.

The dust-up with Allstate capped a year that saw increased regulatory pressure on property insurers. Consumer advocates in the Legislature and the governor's office also enacted increased restrictions on Florida subsidiaries of large insurers, known as "pup" companies. New regulations require that these subsidiaries maintain a $50 million minimum surplus and prohibit the

formation of "pup" companies as of December 31, 2008, as well as imposing new restrictions on what must be included in the rate filings of Florida domiciled subsidiaries. It should be noted, however, that the $50 million surplus requirement will not apply to a Florida-domiciled subsidiary of a Florida-domiciled parent insurer.

The arrival of Gov. Charlie Crist and the continued fallout from the 2005 hurricane season have created a skeptical environment for property insurers, and if the recent Allstate episode and legislative efforts aimed at large, multi-state insurers are any indication, carriers can expect a less kid-gloves regulatory environment for the foreseeable future.

2. Changes at Citizens

In conjunction with increased regulatory oversight on the private insurance market, 2007 saw substantial changes for the state-created residual insurer, Citizens Property Insurance Corporation. Legislation passed in January 2007 changed Citizens from an insurer of last resort, limited to those who could not find coverage in the private market, to a competitor with mainstream insurers. Along with that change came a mandate to lower its rates to achieve such a purpose. Among the measures passed to make Citizens more competitive included rolling back rates to pre-2007 levels and prohibiting increases until 2009. Also, more potential insureds are now

eligible for coverage from Citizens in that an offer of coverage from the private sector does not disqualify an applicant for coverage unless the private sector premium quote was more than 15 percent higher than the premium offered by Citizens.

New legislation also authorized Citizens to assume the policies of the Property and Casualty Joint Underwriting Association and to create a plan to begin offering commercial multi-peril insurance to businesses, although the Office of Insurance Regulation later ordered Citizens to stop selling wind-only policies outside designated high-risk coastal areas. The new multi-peril policies provide up to $2.5 million in coverage and cover perils traditionally found in commercial property policies, such as fire.

3. PIP: Almost as if it never had left

Much ink has been spilled chronicling legislative efforts to save Florida's no-fault auto insurance program, which included mandatory first-party personal injury protection ("PIP"). The previous system was scheduled end October 1, 2007, despite previous legislative efforts to save it. Health care practitioners, particularly emergency rooms and short term care clinics, and the plaintiff's bar, two seemingly divergent groups, have long advocated retaining PIP in its current form. Insurers had long bemoaned the system as rife with fraud, and have advocated medical fee schedules and restrictions on

attorney's fees as countermeasures.

Despite efforts to prevent the no-fault system from sunsetting, PIP did expire on October 1, 2007. Ten days later, Gov. Crist signed a new version into law, which maintained the previous version's requirement that insurers pay for all medical costs up to $10,000. The new version also authorizes the Office of Insurance Regulation to take action against insurers who don't pay valid claims, and attempts to purge the system of fraud by mandating a fee schedule for payments to health care providers. Also, the new version entitles the prevailing party to attorney's fees and costs when fraud is shown.

B. The Federal Regulatory Landscape

1. Extension of the Terrorism Risk Insurance Program (TRIP)

In the wake of the September 11 attacks, cushioning the insurance industry from the effects of major catastrophic losses occasioned by a single event became a legislative priority. These efforts culminated in the passage of the Terrorism Risk Insurance Act of 2002, which established a temporary Terrorism Risk Insurance Program ("TRIP"), designed to allow risk-sharing among public and private entities for commercial property and casualty losses resulting from an act of terrorism, as defined by the statute. TRIP was set to expire on December 31, 2005, but this sunset date was extended to December 31, 2007.

On December 26, 2007, President Bush signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007, which, in addition to extending the program through 2014, made several other notable changes that affect access to the coverage pool, including:

- Revising the definition of "Act of Terrorism" to remove the requirement that the act of terrorism be committed by an individual acting on behalf of any foreign person or foreign interest in order to be certified as a "act of terrorism";

- Setting the federal share of compensation for insured losses for all additional years of the program at 85 percent of that portion of the amount of insured losses that exceeds the applicable insurer deductible;

- Requiring policies issued after the date of the enactment provide clear and conspicuous disclosure language stating the existence of a $100 billion cap on shared federal and insurer liability under the program.

2. Homeowners' Defense Act of 2007

One of the more interesting federal legislative developments of the past year was the passage in the House of Representatives of the Homeowners' Defense Act of 2007, sponsored by U.S. Reps. Ron Klein (D-Boca Raton) and Tim Mahoney (D-Palm Beach Gardens). The act is designed to allow coastal states to pool catastrophic risk and obtain private market insurance coverage by way of catastrophe bonds and reinsurance, with the goal of increasing availability and affordability of homeowners' insurance in high-risk

areas. Title I of the act would allow states to pool catastrophic risks and transfer those risks to reinsurance and catastrophe bonds, while protecting state sponsored insurance funds. Title II would create a National Homeowners Insurance Stabilization Program, which would provide low interest federal loans to states hit by natural disasters.

At the moment, the act's enactment is far from certain, with tepid support in the Senate and the threat of a presidential veto. However, U.S. Sens. Hillary Clinton (D-N.Y.) and Bill Nelson (D-Fla.) have introduced companion legislation in the Senate, giving the issues continued viability in an election year with visions of Hurricane Katrina and its aftermath still fresh in the minds of the electorate.