IN THE DISTRICT COURT OF APPEAL
FIFTH DISTRICT OF FLORIDA

MID-CONTINENT
CASUALTY COMPANY,

Appellant,

v.

Case No.: 5D14-1522
L.T. No.: CA06-815

JAMES T. TREACE, et al.,

Appellees.
_____/

INITIAL BRIEF ON BEHALF OF APPELLANT, MID-CONTINENT CASUALTY COMPANY

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INTRODUCTION

The Record on Appeal shall be referred to as: "R. [volume], [page]" and the trial transcript shall be referred to as: "R. [volume], [page], T. [page:line(s)]."

All emphasis is added unless indicated to the contrary.

STATEMENT OF CASE AND FACTS

The Underlying Action

In September 2006, James and Angeline Treace (collectively "Treace") brought a construction defect action, which ultimately gave rise to this garnishment action. The construction defect action was brought against Mid-Continent Casualty Company's ("MCC") insured, Stevenson Design and Development of Jacksonville, Florida ("SDD"), and others, seeking to recover damages incurred as a result of defects in the construction of their residence. The allegations involved instances of water intrusion below the roof above the front balcony, behind and below the front stone facing around the balcony, and the decks on the other side of the property.

In 2010, Treace amended the complaint to allege two newly discovered defects. First, the installation of virtually all eighty-two (82) windows in the residence was allegedly defective in that the waterproofing around the windows was "reverse lapped." That is, instead of directing water away from the residence it trapped the water inside, causing physical damage to wood below the windows in the form of wood rot. Second, allegedly defective stucco installation allowed water intrusion, which led to wood rot behind the stucco and which also caused corrosion to the stucco lathing.

MCC moved to intervene in the underlying action in order to submit post-verdict jury interrogatories, including interrogatories that would assist in allocating between the various categories of damages. Based on Treace's objection to the intervention, the trial court denied MCC's motion.

On May 1, 2012, the jury rendered a verdict in Treace's favor in the amount of $810,280. On June 26, 2012, the trial court entered a Final Judgment against SDD in the amount of $1,016,187, which amount represented the sum total of the $810,280 in damages awarded by the jury, plus prejudgment interest. On April 30, 2013, the court entered a judgment awarding Treace their attorneys' fees (pursuant to the construction contract) and costs, in the total amount of $379,076. Subsequently, Treace brought this garnishment action, seeking to enforce both judgments against MCC. R. Vol. I, pp. 163-165.

The Garnishment Action

The questions in this garnishment action were not the same as in the prior construction defect action. That is, it was not the trial court's task in this action to determine what repairs were reasonable or necessary or what damages awarded against SDD were proper. Instead, the trial court's task was to determine what part, if any, of the underlying judgments were recoverable under one or more of seven (7) MCC commercial general liability ("CGL") policies.

This action was tried before the trial court on February 18, 2014 after Treace waived a jury. The trial involved testimony and evidence regarding several categories of damages that had been asserted and awarded in the underlying action.

With respect to waterproofing, there was no testimony that the waterproofing itself was physically damaged, only that the waterproofing work damaged a different component of the work, i.e., the wood below. R. Vol. V, 836; T. 119–120.

Similarly, with respect to the stone and decks, the stone and decks were not physically damaged; however, defective installation of control joints allowed water intrusion, which caused physical damage to the balcony and to wood behind and/or below in the form of "wood rot." R. Vol. V, p. 836; T. 119-120; R. Vol. V, pp. 839-40; T. 132-133. In order to remove and replace the rotted wood, Treace's repair contractor Brian Wingate first removed and replaced the stone/decks in each area. R. Vol. V, p. 838; T. 139-140.

The repair of the above defects gave rise to Treace's "Phase I" damages of approximately $400,000. R. Vol. V, p. 844; T. 149:4-6. Wingate's unrebutted testimony was that approximately 20% of his repair costs was for the cost of removing and replacing the rotted wood and approximately 80% was for the cost of removing and replacing the balcony, stone and deck. R. Vol. V, p. 844; T. 150:1-13.

There were two other defects which were allegedly not discovered until 2010. The testimony at trial was that defective stucco installation allowed water intrusion, which led to wood rot behind the stucco and which also caused corrosion to the stucco lathing. Wingate's 20/80 percent testimony also applied to those damages. R. Vol. V, pp. 843-444; T. 148-150.

Also, defective installation of the windows caused wood rot below virtually all 82 windows in the residence in that the waterproofing around the windows was "reverse lapped." Instead of directing water away from the residence, it trapped the water inside causing physical damage to wood below the windows in the form of wood rot. There was no testimony that the window waterproofing was physically damaged, only that the waterproofing work damaged another component of the work, i.e., the wood below. R. Vol. V, p. 836; T. at 119-120.

With respect to the windows themselves, Treace expert (and general contractor for the repairs) Brian Wingate testified that the windows themselves were not physically damaged when installed and that they were not physically damaged when he arrived to perform his repair work. R. Vol. V, p. 843; T. 147:12-22; 148:1-17. His testimony in that regard was unrebutted. He also testified that all windows needed to be removed in order to repair the wood rot. Instead of reinstalling the nondamaged windows following the repair, however, they installed

all new (and much more expensive) windows throughout the home. R. Vol. V, p. 825, T. 74:1-13.

These two defects gave rise to Treace's "Phase II" damages of approximately $493,000. R. Vol. V, p. 844, T. 149:6-7. Treace and MCC stipulated before trial that of the approximately $493,000 in "Phase II" damages, the cost of the new windows and their installation was $210,000. R. Vol. V, p. 835, T. 73:15-16.

MCC contended that with the exception of the cost to remove/repair/replace property damaged by wood rot none of Treace's damages were for "property damage" under a CGL policy, based on Florida case law interpreting that term in the context of CGL policies issued to contractors. R. Vol. V, p. 882-83, T. 271:1 to 274:15. That is, the cost of removing/repairing/replacing a subcontractor's defective workmanship, such as the stone, decks, waterproofing, stucco and windows does not constitute "property damage" under Florida law. *Id.* Only consequential damage to a different subcontractor's work caused by the defective workmanship of the first subcontractor constitutes "property damage" under a CGL policy. *Id.*

Nevertheless, the trial court concluded that coverage existed for all claimed damages except for the cost of new windows, because the court found that the original windows could have been reinstalled. R. Vol. III, pp. 578-580. Although

the court's conclusion was correct, its reasoning was not. Its reasoning should have been that there was not coverage because the original windows had not suffered "property damage." Also, although the court ruled there was no coverage for the cost of the windows themselves, the court nevertheless concluded that there was coverage for the cost of installing them. *Id.* at 580-581.

With respect to the cost of removing/repairing/replacing property damaged by wood rot, MCC contended that all such damages were excluded from coverage by the "Fungus, Mildew and Mold" exclusion contained in all of MCC's policies. The trial court ruled, however, that based on Florida Statutes, § 627.426, MCC could not assert the exclusion. *Id.* at 575-76.

The Mid-Continent Policies

Mid-Continent issued policy number 04-GL-123861, effective from August 1, 2003 to August 1, 2004 (the "2003 Policy") to SDD. R. V. II, pp. 200-46. Mid-Continent renewed the 2003 Policy and the renewal policy number was 04-GL-557139, effective from August 1, 2004 to August 1, 2005 (the "2004 Policy"). *Id.* at 247-302. Mid-Continent renewed the 2005 Policy and the renewal policy number was 04-GL-598319, effective from August 1, 2005 to August 1, 2006 (the "2005 Policy"). *Id.* at 303-344. MCC renewed the 2005 Policy and the renewal policy number was 04-GL-641070, effective from August 1, 2006 to August 1, 2007 (the "2006 Policy"). *Id.* at 345-396. Mid-Continent renewed the 2006 Policy

and the renewal policy number was 04-GL-683408, effective from August 1, 2007 to August 1, 2008 (the "2007 Policy"). R. V. III, pp. 397-454. Mid-Continent renewed the 2007 Policy and the renewal policy number was 04-GL-725574, effective from August 1, 2008 to August 1, 2009 (the "2008 Policy"). *Id.* at 455-503. Mid-Continent renewed the 2008 Policy and the renewal policy number was 04-GL-764283, effective from August 1, 2009 to August 1, 2010 (the "2009 Policy"). *Id.* at 504-557.

The policies provide in relevant part as follows:

> **SECTION I – COVERAGES**
>
> **COVERAGE A. BODILY INJURY AND PROPERTY DAMAGE LIABILITY**
>
> **1. Insuring Agreement**
>
> **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. We will have the right and duty to defend any suit seeking those damages. We may, at our discretion, investigate any occurrence and settle any claim or suit that may result. ...
>
> **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 place in the "coverage territory", and
>
> **(2)** The "bodily injury" or "property damage" occurs during the policy period...

The policies contain the following relevant definitions:

> **SECTION V – DEFINITIONS**
>
> **13.** "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. [MCC Policies at V (13)].
>
> **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. [MCC Policies at V (18)].

All of MCC's policies contain a "Fungus, Mildew and Mold" exclusion, Form ML 1217(04 01), which provides in relevant part as follows:

> This insurance does not apply to ... "property damage" ... **arising out of**, resulting from, caused by, **contributed to, attributed to, or in any way related to** any fungus... .

(emphasis added).

SUMMARY OF THE ARGUMENT

The trial court erred as a matter of law in ruling that all claimed damages other than the cost of new windows constituted "property damage" under MCC's

CGL policies. There are several Florida appellate cases including Supreme Court of Florida cases, and also federal cases applying Florida law, involving the exact issues in this case, i.e., what coverage is available to a general contractor in the context of a construction defect action under a standard Insurance Services Office, Inc. ("ISO") CGL coverage form such as that used by MCC. In the instant action, the trial court failed to follow that precedential case law because it failed to recognize the distinction between the removal/repair/replacement of other components of the work caused by a subcontractor's defective work, which constitutes "property damage," and the removal/repair/replacement of the subcontractor's own work, which does not constitute "property damage" under a general contractor's CGL policy.

The Supreme Court of Florida's decision in *United States Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007) ("*J.S.U.B.*") is recognized as the seminal case on these issues and the foundation for all subsequent decisions, including another highly significant and relevant case from the Supreme Court of Florida, *Auto-Owners Ins. Co. v. Pozzi Window Co.*, 984 So. 2d 1241 (Fla. 2008).

As discussed below, the courts make significant distinctions between (1) defective work that is not physically damaged, (2) defective work that only damages itself but not another component of the work, and (3) defective work that damages another component of the work. Only the latter category, i.e., physical

damage caused by one subcontractor's work to the work of a different subcontractor, i.e., a different component of the general contractor's work, constitutes "property damage" under *J.S.U.B.*, *Pozzi Windows* and their progeny. The first two categories, however, do not constitute "property damage" under the case law. For those categories of damages, one need not even consider exclusions because the policy's insuring agreement, i.e., the grant of coverage requiring "property damage," has not been met. As established below, in the instant action the trial court erred as a matter of law in concluding that all of Treace's damages were for "property damage" because it failed to properly apply the precedential and persuasive cases discussed herein.

The trial court also erred as a matter of law in concluding that the "Fungus, Mildew and Mold" endorsement did not bar coverage for some damages, namely, the removal/repair/replacement of rotted wood. At trial, Treace's engineering expert testified that wood rot cannot exist without the presence of fungi. R. Vol. V, p. 868, T. 217:7-18. Accordingly, MCC moved for the pleadings to be amended to conform to the evidence and in particular Newkirk's testimony, to allow MCC to assert the fungus exclusion. R. Vol. V, p. 873, T. 234:11 to 237:2.

The trial court allowed the pleadings to be conformed to the evidence such that MCC's fungus exclusion was deemed to be asserted as an MCC affirmative defense. R. Vol. V, p. 874, T. 241:16-25. Following trial, however, the trial court

ruled that MCC could not rely on the exclusion based on Florida Statutes, § 627.426. R. Vol. III, pp. 575-76. The court's ruling in that regard constituted legal error because in *AIU Ins. Co. v. Block Marina Investment, Inc.,* 544 So. 2d 998 (Fla. 1989), the Supreme Court of Florida interpreted the statute and held that it only applies to coverage defenses based on conditions such as late notice, and not to exclusions.

For the reasons set forth below, this Court should reverse the trial court and direct the court to enter judgment in favor of MCC.

ARGUMENT

I. THE TRIAL COURT ERRED AS A MATTER OF LAW IN RULING THAT ALL CLAIMED DAMAGES OTHER THAN THE COST OF NEW WINDOWS CONSTITUTED "PROPERTY DAMAGE" UNDER FLORIDA LAW.

There are several cases in Florida state and federal court jurisprudence discussing what coverage is available to a general contractor in the context of a construction defect action under a standard Insurance Services Office, Inc. ("ISO") CGL coverage form such as that used by MCC. In the instant action, however, the trial court failed to follow that precedential case law.

A. Florida Courts Recognize A Distinction Between Removal/Repair/ Replacement Of Other Components Of The Work Caused By A Subcontractor's Defective Work, Which Constitutes "Property Damage," And Removal/Repair/Replacement Of The Subcontractor's Own Work, Which Does Not Constitute "Property Damage" Under A General Contractor's CGL Policy.

Prior to the Supreme Court of Florida's decision in *United States Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007) ("*J.S.U.B.*"), the law in Florida was that there was no coverage under a general contractor's CGL policy for property damage to any part of the work, whether or not some or all of the work had been performed by subcontractors. *See Lassiter Constr. Co. v. American States Ins. Co.,* 699 So. 2d 768 (Fla. 4th DCA 1997). However, *Lassiter* was disapproved by *J.S.U.B.*

Accordingly, *J.S.U.B.* is now recognized as the seminal case and the foundation for all subsequent decisions applicable to the question of what coverage is available to a general contractor under its CGL policy for construction defects. Another relevant case, *Auto-Owners Ins. Co. v. Pozzi Window Co.,* 984 So. 2d 1241 (Fla. 2008), started in a federal forum but was ultimately decided by the Supreme Court of Florida when the Eleventh Circuit certified questions.

Under *J.S.U.B.* and *Pozzi Windows,* as well as the cases that followed those two decisions, the first question in this case is, what constitutes "property damage" as that term has been interpreted in the context of a general contractor's CGL policy where, as here, the work was performed by subcontractors? The courts

make significant distinctions between (1) defective work that is not physically damaged, (2) defective work that only damages itself but not another component of the work, and (3) defective work that damages another component of the work. Only the latter category constitutes "property damage" under *J.S.U.B.*, *Pozzi Windows* and their progeny. The first two categories, however, do not constitute "property damage," and therefore, do not implicate the policy's insuring agreement.

In *J.S.U.B.,* the court concluded that "defective work performed by a subcontractor that causes damage to the contractor's completed project ... can constitute 'property damage' caused by an 'occurrence' as those terms are defined in a standard form commercial general liability policy." Like MCC's policies under which the trial court found coverage in this action, the policy in *J.S.U.B.* contained a "subcontractor exception" to the "damage to your work" exclusion. But as stated by the *J.S.U.B.* court, "[o]f course, the subcontractor's exception to the general exclusion for a contractor's defective work becomes important only if there is coverage under the initial insuring provision." *Id.* at 880.

The court further stated: "[F]aulty workmanship or defective work that has damaged the otherwise nondefective completed project has caused 'physical injury to tangible property' within the plain meaning of the definition of the policy. If there is no damage beyond the faulty workmanship or defective work, then there

may be no resulting 'property damage.'" *Id.* at 889. *See also Amerisure Mut. Ins. Co. v. Auchter Co.,* 673 F.3d 1294 (11th Cir. 2012)(applying *J.S.U.B* and *Pozzi Windows* and stating that under Florida law a general contractor's CGL policy did not provide coverage for the removal of a defective roof installed by the roofing subcontractor that did not damage any other subcontractor's work because the removal and replacement of the roof did not constitute "property damage").

The Supreme Court of Florida restated the rule in *Auto Owners Ins. Co. v. Pozzi Window Co.,* 984 So. 2d 1241, 1248 (Fla. 2008), stating: "There is a difference between a claim for the costs of repairing or removing defective work, which is not a claim for 'property damage,' and a claim for the costs of repairing damage caused by the defective work, which is a claim for 'property damage.'"). Thus, if there is no damage beyond the faulty workmanship or defective work, then there is no resulting "property damage." *Id.* See also 9A *Russ and Segala Couch on Ins.,* §129:6 (3rd Ed.) ("The costs incurred to repair a defective product or defective work do not constitute property damage under a commercial general liability policy."); *Assurance Co. of America v. Lucas Waterproofing Co.,* 581 Supp. 2d 1201, 1209 (S.D. Fla. 2008)(applying *J.S.U.B.* and *Pozzi Windows* and finding that although the cost of repairing other components of the work damaged because of defective waterproofing was for "property damage," the cost of removing and replacing the defective waterproofing itself was not for "property

damage"); *Arnett v. Mid-Continent Cas. Co.,* 2010 WL 2821981 (S.D. Fla. 2010) (applying *J.S.U.B.* and *Pozzi Windows* to a general contractor's policy and stating that under Florida law, "[c]overage therefore extends to costs to repair damages caused by construction defects, but not to repair or replace the defective work itself").

The opinion of the Southern District of Florida in *Assurance Company of America v. Lucas Waterproofing Co. Inc.,* 581 F.Supp. 2d 1201 (S.D. Fla.2008) is relevant. That case involved an insurance coverage dispute arising out of construction defects in work performed on condominium complexes in Vero Beach, Florida. There, it was claimed that membrane waterproofing under cast stone pavers on the porches of the condominiums had been defectively installed. The work was completed on July 25, 1999, and shortly thereafter the buildings were exposed to wind and rain from Hurricanes Floyd and Irene. The owner brought suit against the contractor alleging construction design defects in the buildings, "including property damage caused by water inside the decorative soffit beams under the balconies, resulting in peeling and bubbling paint and mildew growth, as well as stucco discoloration or efflorescence." *Id.* at 1204.

In considering the coverage issues raised by that case, the court reviewed the insurance policy's provisions regarding "property damage" caused by an "occurrence." *Id.* at 1209. There, the pertinent policies defined "property damage"

as "physical injury to tangible property, including all resulting loss of use of that property." *Id.* That is, of course, the same definition as in the policies in the instant action. The court stated the following regarding what was, or was not, "property damage":

> A claim for the cost of removing or repairing defective work does not constitute a claim for "property damage." A claim for the cost of repairing damage of other elements of the subject property that was caused by the defective work is a claim for "property damage" under a CGL policy.
>
> Thus, any claim for costs incurred by repairing the defective waterproofing is not covered by the TransContinental policies. However, costs incurred by repairing damages to other parts of the buildings that were damaged as a result of the defective waterproofing constitutes "property damage" and may be covered by the TransContinental policies.

Id.

The court's ultimate ruling in that case was that the policy did not provide coverage for the owner's claim for repairs of the defective work, and that the policy would provide coverage only to the extent that the defective work damaged other portions of the buildings including the soffit beams, stucco, and peeling and bubbling paint. *Id.*

The facts of the instant action must be considered in light of the above cases, in order to determine which categories of Treace's alleged damages were for "property damage" under MCC's policies. As established in the following section discussing each element of damages specifically, it is clear that the trial court erred

as a matter of law in finding coverage for nearly all of Treace's damages by failing to properly apply the precedential and persuasive cases cited above.

B. The Trial Court Erred As A Matter Of Law By Failing To Follow Precedent And Instead Finding That Virtually All Of Treace's Damages Were For "Property Damage" As That Term Applies To MCC's CGL Policies.

With respect to stucco one of Treace's experts, Wingate, testified that no stucco was physically damaged except for a 6' by 3' area. R. V., p. 843, T. 147:1-7. But Treace's other expert, Newkirk, testified that virtually all of the "stucco system" suffered physical damage in one sense. R. V., pp. 867-868, T. 213:17 to 214:16. He explained that although the stucco itself was not physically damaged, defective installation of control joints and weep screed allowed water intrusion through the stucco that reached the lathe (which Newkirk compared to "chicken wire"). *Id.* Newkirk testified that as a result virtually all of the lathe oxidized/rusted. R. V., p. 868, T. 215:1-9.

Significantly for purposes of coverage, Newkirk testified that applying the stucco to the lathe and installing the control joints and weep screed would have been the work of one and the same subcontractor, i.e., the stucco contractor, and that all of this work together constituted a system that constituted only one component of work. *Id.* Newkirk's testimony is consistent with MCC's definition of "your work," which means "[w]ork or operations performed by you or on your

behalf; and [m]aterials, parts or equipment furnished in connection with such work or operations." D-6, pg. 15 of Commercial General Liability Coverage Form.

The trial court erred in finding coverage for the removal and replacement of stucco. The *J.S.U.B.* decision addresses this exact issue, as it cited with approval a prior decision by the Third District Court of Appeal, *Auto Owners Ins. Co. v. Tripp Constr., Inc.,* 737 So. 2d 600 (Fla. 3d DCA 1999) for recognizing the distinction between the cost of repairing and replacing the actual defects in the construction, which is not covered, and the cost of repairing the damage caused by defective components to other elements of the subject homes, which was covered. *J.S.U.B.,* 979 So. 2d at 889 (citing *Tripp,* 737 So. 2d at 601-602).

Thus, although the trial court could have found coverage for the damage to other components of the work caused by defective stucco installation (subject to any applicable exclusions), the court erred as a matter of law in finding coverage for the removal and replacement of the stucco component itself, because the cost of removing and replacing the defective stucco component does not constitute "property damage" under a CGL policy pursuant to *J.S.U.B.* and the other cases discussed above.

With respect to stone and decks, the undisputed testimony was that the stone and decks were not physically damaged. R. V., pp. 840-841, T. 136:23-25 to 137:10; 139:4-7. Therefore, as with the stucco defect discussed above, the trial

court erred as a matter of law in ruling that the cost of removing and replacing the nondamaged stone and decks to get to the rotted wood was a claim for "property damage."

With respect to the balcony, the cost of replacing rotted wood in other components caused by the defective balcony installation constitutes "property damage" (subject to any applicable exclusions), but the cost of removing and replacing the balcony because it caused damage to itself does not constitute "property damage."

As to the replacement of all windows with new windows, the trial court properly found that the cost of the new windows themselves was not covered, although its reasoning was flawed. The court concluded that the original windows could have been reused. R. Vol. III, p. 580. The court should have instead concluded that because the unrebutted testimony was that the windows were not damaged, their replacement was not for "property damage." The court also erred as a matter of law in finding that the cost of removing and reinstalling windows was for "property damage," in light of the case law discussed above.

As a result, the only category of damages that was for "property damage" under a CGL policy pursuant to *J.S.U.B.* and the other cases discussed above, thus meeting the insuring agreement, was the cost of removing and replacing rotted wood, which according to Wingate was 20% of the total damages of $810,000, i.e.,

$162,000. Therefore, the trial court should have found that the total of all covered damages was only $162,000 at most, subject to the applicability of the fungus exclusion as discussed in the following section. This Court should reverse and rule as a matter of law that only $162,000 of Treace's damages fall within the insuring agreement, subject to the exclusion discussed in the following section.

II. THE TRIAL COURT ERRED AS A MATTER OF LAW IN FINDING THAT THE "FUNGUS, MILDEW AND MOLD" ENDORSEMENT DID NOT BAR COVERAGE FOR SOME OF THE CLAIMED DAMAGES.

According to Treace engineering expert Brett Newkirk's trial testimony, there are two causes that work together to cause wood rot, namely water and fungi. R. V., p. 868, T. 216:19 to 217:2. Exposure to water each time it rained because of defective construction caused "wettings" and "dryings," which "wettings" created an environment for fungi to exist and, for lack of a better word, "eat" the wood. R. V., p. 868, T. 216:6-25. According to Newkirk, wood rot cannot occur but for the presence of both water and fungi. R. V., p. 868, T. 216:19 to 217:18.

All of MCC's policies contain a "Fungus, Mildew and Mold" exclusionary endorsement, form no. ML1217 (04/01). Although that exclusion was a basis of MCC's reservation of rights letters, MCC's counsel did not assert it as an affirmative defense in this action because there was no allegation of fungus, mildew or mold. R. Vol. V, p. 874, T. 239:8-25. Instead, the reference to fungus came from Newkirk, Treace's expert, at trial. R. Vol. V, p. 873, T. 234:5 to 237:2.

The first time MCC's counsel heard such testimony was one week before the trial of the instant action, during a trial of another matter in the U.S. Middle District where Newkirk testified as a plaintiff's expert. *Carithers v. Mid-Continent Cas. Co.,* case no. 3:12-cv-00890. *Id.* That matter also involved MCC and undersigned counsel. In that federal action, MCC moved to amend the pleadings to conform to the evidence and to allow MCC to assert its fungus exclusion as an affirmative defense based on Newkirk's testimony. Ultimately, the federal court ruled that MCC could not rely on the exclusion based on Florida Statutes, § 627.426. The federal court's ruling is currently on appeal to the U.S. Eleventh Circuit, case no. 14-11639. The U.S. Eleventh Circuit has notified the parties that oral argument will be necessary.

At trial in the instant action, MCC moved for the pleadings to be amended to conform to the evidence, in particular Newkirk's testimony in this action (as he testified in the federal action) that wood rot is caused by both water and fungi, to allow MCC to assert the fungus exclusion. *Id.* Treace had never alleged that any property damage was caused by fungi. The word "fungi" does not appear in any Treace pleading or motion. Although MCC was previously aware of the existence of wood rot, Newkirk's testimony in this trial was the first time that anyone explained to MCC and its counsel that fungi were required in order for wood rot to exist. *Id.* Also, MCC's adjusters and its counsel may have inspected the property

and/or seen examples of rotted wood, but they are not engineers or scientists and cannot be deemed to have the scientific knowledge of an engineering expert such as Newkirk.

The trial court allowed the pleadings to be amended to conform to the evidence such that MCC's "Fungus, Mildew and Mold" exclusion was deemed to be asserted as an MCC affirmative defense. R. Vol. III, pp. 574-75. Following trial, however, the trial court concluded that MCC had knowledge of Treace's water damage and wood rot claims for years and was thus also deemed to have knowledge of the definition of the word "rot," which includes action by bacteria or fungus. *Id.* at 575. The trial court further found that because MCC was deemed to have such knowledge, it could have notified Treace earlier of its reliance on the exclusion. *Id.* at 575-76. The trial court stated that the first time MCC ever asserted the exclusion was at trial, ignoring the fact that MCC had raised the exclusion in its reservation of rights letters. *Id.* at 575-76; R. Vol. V, p. 874, T. 239:6-12.

Also, even though the trial court had allowed the exclusion as an affirmative defense at trial, the court held that MCC could not rely on the exclusion based on § 627.426. The court's ruling in that regard expressly followed/adopted the ruling in the federal action, *Carithers*. R. Vol. III, pp. 575-76.

The Fungus, Mildew and Mold exclusion found in each MCC policy applies quite broadly in that it states:

> This insurance does not apply to ... "property damage" ... **arising out of**, resulting from, caused by, **contributed to, attributed to, or in any way related to** any fungus... .

Form ML 1217(04 01) (emphasis added).

Florida courts interpret the term "arising out of" very broadly, even in an exclusion, to mean among other things "growing out of," "flowing from," "incident to" or "having a connection with." It requires some causal connection, or relationship" but it does not require proximate cause. *Taurus Holdings, Inc. v. U.S. Fid. & Guar. Co.*, 913 So. 2d 528, 539-540 (Fla. 2005). Effectively, "arising out of" means "but for" causation. *Eastpointe Condo. I Ass'n, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 664 F. Supp. 2d 1281, 1288 (S.D. Fla. 2009) *aff'd,* 379 F. App'x 906 (11th Cir. 2010). The trial court thus erred as a matter of law in finding that the Fungus, Mildew and Mold exclusionary endorsement does not bar coverage for the removal, repair and/or replacement of wood rot.

Importantly, Newkirk's testimony that wood rot requires both water and fungi does not constitute testimony of "concurrent causes" for purposes of insurance coverage. There are cases discussing the circumstance of "concurrent causes," one covered and one not, where the analysis involves whether the two causes are interdependent or independent. If the covered cause could have caused

the injury or damage by itself, then coverage exists even though there was also a noncovered cause. *See, e.g., American Sur. & Cas. Co. v. Lake Jackson Pizza,* 788 So. 2d 1096 (Fla. 1st DCA 2001) (citations omitted). That analysis does not apply here, however, because water could not have caused wood rot by itself.

The court's ruling that the exclusion did not apply also constitutes clear legal error, because § 627.426 cannot deprive MCC of the exclusion as a defense. By its express terms, § 627.426 can create an estoppel where an insurer fails to properly reserve rights with respect to a "particular coverage defense." In interpreting that statute, however, the Supreme Court of Florida has stated that the statute only applies to coverage defenses based on conditions such as late notice, and not to exclusions. *AIU Ins. Co. v. Block Marina Investment, Inc.,* 544 So. 2d 998 (Fla. 1989). The *AIU* court stated:

> We do not construe the term to include a disclaimer of liability based on a complete lack of coverage for the loss sustained. Under this construction, for example, if the insurer fails to comply with the requirements of the statute, it may not declare a forfeiture of coverage which otherwise exists based on a breach of a condition of the policy. However, its failure to comply with the requirements of the statute will not bar an insurer from disclaiming liability where a policy or endorsement has expired or where the coverage sought is expressly excluded or otherwise unavailable under the policy or under existing law.

AIU, 544 So. 2d at 999.

Because §627.426 cannot create an estoppel where the insurer relies on an exclusion, the trial court erred as a matter of law in relying on that statute to

deprive MCC of the exclusionary defense. The court's misinterpretation of §627.426 constitutes legal error. Therefore, this Court should hold that the "fungus, mildew and mold" exclusion bars coverage for all damages associated with wood rot. As a result, the $162,000 for wood rot removal/repair/replacement that otherwise constituted "property damage" is excluded. Accordingly, Treace should take nothing in this action.

CONCLUSION

For the reasons stated herein, this Court should reverse and direct the trial court to enter judgment in favor of MCC.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served by *e-mail and/or U.S. Mail* on this 29th day of September, 2014, on all counsel or parties of record on the attached Service List below.

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CERTIFICATE OF COMPLIANCE

I HEREBY CERTIFY that this Initial Appellant Brief is in compliance with the font requirements of Rule 9.100(1).

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