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PRESS RELEASE

No Coverage under Design Defect Exclusion in Builder's Risk Policy for Repairing Structural Defects in Condominium Building; Actual Covered Loss is Prerequisite to Application of Sue and Labor Clause

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In a case in which WRF represented Zurich American Insurance Company, the Florida Supreme Court, answering two certified questions from the Eleventh Circuit on issues of first impression, unanimously held that a design defect exclusion in a builder's risk policy barred coverage for the costs of repairing structural defects in a condominium building, that the "ensuing loss" exception to the exclusion did not restore coverage and that the policy's sue and labor clause did not apply because no actual covered loss existed. Swire Pacific Holdings, Inc. v. Zurich Insurance Co., No. SC02-613 (Fla. April 10, 2003).

The policyholder, the developer of a condominium project, sought coverage under its builder's risk policy for costs incurred to correct design defects in the project arising out of the structural engineer's failure to comply with governmental building codes and ordinances. To bring the project into compliance with those codes, the policyholder was required to demolish and rebuild certain portions of the buildings. The insurer denied coverage, contending that an exclusion for design defects barred coverage. The policyholder then filed suit and both parties moved for summary judgment.

The district court granted summary judgment to the insurer, determining that the design defect exclusion barred coverage. The court further ruled that the ensuing loss exception, which restored

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coverage for "physical loss or damage resulting from such fault, defect, error or omission in design, plan or specification," did not apply. The court also held that the sue and labor provision did not provide coverage for the loss. The policyholder appealed to the United States Court of Appeals for the Eleventh Circuit. The Eleventh Circuit determined that there were issues of first impression and certified the following questions to the Florida high court:

- Whether the policy's Design Defect Exclusion Clause bars coverage for the cost of repairing the structural deficiencies in the condominium building;
- If the first question is answered in the affirmative, whether the policy's Sue and Labor Clause applies only in the case of an actual, covered loss;
- If the second question is answered in the negative, whether the policy's Sue and Labor Clause covers the cost of repairing the structural deficiencies in the condominium building.
- The Florida high court answered the first question in the affirmative, determining that the design defect exclusion unambiguously barred coverage. In so holding, the court rejected the policyholder's argument that the exclusion was ambiguous because the policy did not define the terms "loss or damage" and "physical loss or damage." The court noted that the policyholder provided neither case law nor conflicting definitions to support the conclusory contention. The court found that the plain language of the exclusion "clearly" excluded from coverage "loss caused directly by [a] design defect." Accordingly, the court determined that the actions undertaken by the policyholder to remedy defective design of the building clearly fell within the exclusion.

The court next ruled that the ensuing loss exception did not restore coverage under the exclusion. The ensuing loss exception restored coverage for "physical loss or damage resulting from such fault, defect, error or omission in design, plan or specification." The court initially observed that "'physical loss or damage' as used in the ensuing loss provision of the clause is damage that occurs subsequent to, and as a result of, a design defect." Here, " no loss separate from, or as a result of, the design defect occurred." The court therefore determined "that under the clear contractual provisions along with the authority of numerous courts," the policyholder was not entitled to coverage for the costs of repairing the defect. In so ruling, the court noted that "[t]o hold otherwise would be to allow the ensuing loss provision to completely eviscerate and consume the design defect exclusion." The court further opined that the policyholder's reading would transform the policy into "a warranty for faulty workmanship" and "a guarantee against design and construction defects."

The court then rejected the policyholder's contention that the sue and labor clause afforded coverage. The court held that expenses are recoverable under the sue and labor clause only when an actual covered loss has occurred or was in the process of occurring. The court reasoned that "under the plain language of the provision, sue and labor expenses are stated to be recoverable only in the case or loss or damages, not simply when one asserts that the expenses are to prevent a loss." In so ruling, the court found the cases relied upon by the policyholder factually distinguishable because a covered loss had already occurred or was in the process of occurring in those cases and thus the courts were focusing on "mitigation, not prevention." Here, the court noted that the policyholder was acting to prevent a potential collapse. Because no actual covered loss

had taken place, the court concluded that the sue and labor clause was inapplicable.