

# Client Advisory

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## Update on Florida Surplus Lines Law and Essex Insurance Company v. Zota

To Our Friends and Clients:

Since our initial advisory on this subject in October, 2008, there have been several developments impacting the Surplus Lines insurance market, and minimizing the effects of the Florida Supreme Court's decision in *Essex Insurance Company v. Zota*, 985 So.2d 1036 (Fla. 2008). As we mentioned in our October Advisory, the rulings from the Supreme Court in *Essex v. Zota*, and the Federal Court in *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.*, 291 Fed. Appx. 220 (11<sup>th</sup> Cir. August 18, 2008) were potentially quite troubling in that a literal interpretation of these decisions could have caused any Surplus Lines policy to be voided simply because of "non-compliance" with the filing and approval process under Florida's Insurance Code. The concern expressed by insurers and regulators was significant enough to cause the Florida Insurance Commissioner, the Office of Insurance Regulation, as well as the Florida Legislature to take immediate steps to address the situation.

The Florida Legislature was the first to act. At the close of the 2009 legislative session earlier this month, the Florida House of Representatives, and Senate passed an amended version of F.S. §626.913 which declared, without leaving any room for ambiguity, that Surplus Lines insurers did not have to comply with the filing and approval process under Chapter 627 of Florida Statutes before issuing a Surplus Lines policy. This legislation was strongly supported by the insurance industry as well as the Florida Insurance Commissioner. It is also consistent with the longstanding practice of Surplus Lines carriers, and the OIR's own interpretation of the insurance code.

The trial lawyers fought against this legislation and sought to prosecute a class action against the industry for all policies written since 1988. Conversely, the insurance industry fought to make the legislation retroactive back to 1988. In the end, the Legislature reached a compromise, whereby the regulatory exemption which surplus lines insurers enjoyed would be made retroactive to 1988, but allowing for individual insureds to file *Essex* type lawsuits up through and including May 15, 2009. The trial bar also was able to negotiate an automatic fee award provision applicable to surplus insurers, similar to what has long been in place for admitted carriers under Florida Statute 627.428, whereby a prevailing insured in a declaratory or breach of contract action is awarded reasonable attorneys fees and costs. The legislation passed nearly unanimously and is expected to be signed into law forthwith.

Meanwhile in the courts, after *Essex v. Zota* was remanded to the Southern District of Florida, the Federal Court conducted further proceedings which culminated in the Court's order on the parties' respective motions for summary judgment. Judge Cohn, recognizing that he was bound by the Florida Supreme Court's rulings on the compliance issue, (notwithstanding the

forthcoming legislative changes) sought to apply the Supreme Court's findings in light of the underlying facts presented by the parties.

On remand Essex argued that the exclusionary endorsement should not be held void since an insurer's non-compliance cannot be used by an insured to create or resurrect coverage that never existed under the policy in the first place. Citing *AIU Ins. Co. v. Block Marina Investment, Inc.*, 544 So.2d 998 (Fla. 1989). Essex further argued that it was significant that the insured was only asking the Court to void certain exclusions and thereby find coverage under the remaining, surviving, provisions of the policy - in other words, that the insured was trying to have its cake and eat it too. However, Judge Cohn correctly noted that to allow this remedy would have had the effect of altering the terms of the insurance contract since the exclusions formed part of the contract bargained for by Essex and its insured.

Although the Court recognized that Surplus Lines insureds were bound by Part Two of the Florida Insurance Code (including the filing and approval of provisions of §'s 926.916, 626.923, and 627.410), Judge Cohn found that a strict application of the holding from *Am. Mut. Fire Ins. Co. v. Illingworth*, 213 So.2d 747 (Fla. 1<sup>st</sup> DCA 1968) would be unduly harsh. In *Illingworth*, (a case relied upon by the Supreme Court in its *Essex* decision) an intermediate appellate court ruled that the mere failure to file the form with the Office of Insurance Regulation rendered the policy exclusion void.

Instead, Judge Cohn relied on §627.418(1), and found that the exclusionary endorsement, although not filed with or approved by the OIR, would nonetheless be valid despite non-compliance with the Insurance Code. The Court reasoned that voiding only the exclusionary endorsement, but allowing the remainder of the policy to remain in effect without the exclusions, would be unfair to insurers and raise "grave constitutional concerns." Conversely, the Court found that a Surplus Lines insurer should not receive an indirect benefit (such as it might in a catastrophic injury case) of having the entire policy rescinded thereby allowing the Surplus Lines insurer to escape any obligations under the contract and instead only have to provide a return premium. Judge Cohn quoted from the opinion in *Chalfonte Condominium Apartment Association, Inc. v. QBE Insurance Corp.*, 526 F. Supp. 2d 1251 (S.D. Fla. 2007) noting that although §627.418 may have been intended to benefit policy holders, and not insurers, the statute suggests that in the absence of an express penalty in the compliance statute, courts should assume that a policy provision is valid despite non-compliance with the insurance code.

At the end of the day, the Court was still left with the question of what would be an appropriate remedy in a circumstance where a Surplus Lines insurer had failed to comply with the Florida Insurance Code, including specifically Sections 626.923, 627.410 and 626.916(1)(c). The Court found that since there is no monetary penalty or fine called for pursuant to a violation of 627.410, he could not simply assess one, notwithstanding the fact that that statute was clearly violated. Accordingly, Judge Cohn's answer to the ultimate question presented by the Supreme Court's opinion in *Essex* (i.e., what is the insurer's penalty for failure to comply), appears to be (*much ado about*) nothing.

*For additional information on these issues, please contact Jim Kaplan or Mike Sastre.*