IN THE SUPREME COURT OF MISSISSIPPI

No. 2008-CA-01353

ARCHITEX ASSOCIATION, INC. **APPELLANT**

V.

SCOTTSDALE INSURANCE COMPANY **APPELLEE**

On Appeal from the granting of the Motion for Summary Judgment of Scottsdale Insurance Company, from the Circuit Court of Rankin County, Mississippi, Twentieth Judicial District (Cause No. 2002-219)

BRIEF OF AMICUS CURIAE MISSISSIPPI DEPARTMENT OF FINANCE AND ADMINISTRATION, BUREAU OF BUILDING, GROUNDS, AND REAL PROPERTY MANAGEMENT, MISSISSIPPI INSURANCE DEPARTMENT, MISSISSIPPI DEPARTMENT OF TRANSPORTATION, AND THE STATE OF MISSISSIPPI, *EX REL.* ATTORNEY GENERAL JIM HOOD

ORAL ARGUMENT IS NOT REQUESTED

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The Mississippi Department of Finance and Administration, Bureau of Building, Grounds, and Real Property Management, the Mississippi Insurance Department, the Mississippi Department of Transportation, and the State of Mississippi, by and through Attorney General Jim Hood, as amicus curiae file this brief pursuant to Rule 29(a) of the Mississippi Rules of Appellate Procedure and present to the Court pertinent matters of statewide public interest as discussed herein.

ARGUMENT

I. The Mississippi Legislature has statutorily mandated that the State's interests must be protected on public projects.

The interests of the State of Mississippi, with respect to the issue before this Court, require amicus curiae to articulate the role that a general contractor's comprehensive commercial general liability (CGL) policy plays in a public construction project. The Mississippi Department of Finance and Administration and the Institutions of Higher Learning alone authorize, on average, approximately three hundred fifty million dollars ($350,000,000.00) of the public's money annually on its public construction projects. Capital outlay for construction projects for Fiscal Year 2008 by the Mississippi Department of Transportation was over six hundred five million dollars ($605,000,000.00). Other state entities likewise authorize and spend public funds on construction projects, including the Mississippi Development Authority, Employment Security Commission, MEMA, Veterans' Affairs, and others. The Mississippi Legislature has addressed the administration of such public contracts in Mississippi Code Ann. Section 31-5-1 *et seq.* in detail. For example, Miss. Code Ann. Section 31-5-3 provides that "[a]ny person, firm or corporation entering into a formal contract with this state . . . for the construction or maintenance of public buildings, works or projects . . . shall be required before

commencing same to execute the usual bond with good and sufficient sureties." Furthermore, Section 31-5-51 requires, in subsection (1), the submission of performance and payment bonds and, in subsection (7), specifically requires the furnishing of proof of the contractor's general liability insurance coverage in an amount not less than One Million Dollars ($1,000,000.00) for bodily injury and property damage. The legislature's clear intention was to ensure the protection of the State's interests and assets by requiring the submission of performance bonds and sureties and proof of insurance coverage.

Subsection (1)(a) of Section 31-5-51 states that any person entering into a contract with the state or political subdivision thereof shall furnish a "performance bond payable to, in favor of or for the protection of such public body, as owner, for the work to be done in an amount not less than the amount of the contract, conditioned for full and faithful performance of the contract." The performance bond and sureties serve to ensure and certify to the State and its taxpayers that, in the event the contractor defaults on the construction project, the surety company will ensure that the project is fully performed and completed, either by takeover agreement or by tender agreement. Once the project has been completed and final payment is made, the public owner has one (1) year after final payment to bring suit on the performance bond, pursuant to Section 31-5-53. Once the warranty period has expired, any claim the public owner makes should be against the contractor within the relevant limitations of actions period. The owner generally has no recourse against subcontractors for construction defects since the State has no privity of contract with the subcontractors and has no standing for involvement in the contractual relationship between the contractor and the subcontractors. The State naturally must look to the contractor's general liability insurance coverage for any claims it may have regarding construction issues.

Historically, the general contractor performed the majority of its own construction work and, in rare instances, hired subcontractors to construct specialized portions of the construction project. In today's construction industry, it is uncommon to find that same historical relationship. Today's general contractor serves more as a superintendent to the construction project and spends its time managing subcontractors that have been hired to perform various portions of the construction process. Given the nature of the modern general contractor and its propensity to "sub out" the work, to determine that subcontractor work, whether defective or not, would not be covered under the contractor's comprehensive commercial general liability policy, coverage which is required by the Legislature for public construction contracts, exposes the State to an enormous amount of risk exposure and liability with no recourse. If the contractor was relieved of liability for work performed by his subcontractors who perform construction work on the contractor's behalf, so that all risk was borne by the State, there would be absolutely no reason for requiring the general contractor to acquire liability coverage in the first place. To require the general contractor to provide proof of general liability insurance coverage amounts to an effort in futility since it serves no purpose. In essence, the comprehensive commercial general liability policy would be meaningless to the State. Not only does such a result negate the measures that the Mississippi Legislature has taken to adequately protect the interests and assets of the State and its taxpayers, it creates a windfall for those insurance companies that collect and willingly accept a contractor's insurance premiums on a policy for which the insurance companies essentially have absolutely no exposure. To permit such an unconscionable result leaves the State of Mississippi in the incredibly vulnerable position of assuming an enormous amount of financial and liability risk at the expense of its taxpayers.

II. Construction defects that cause damage should be interpreted and covered as occurrences under CGL insurance policies.

The cost of repair for construction defects involving public facilities may be much more than the cost of the budgeted project itself. Therefore, an owner must be able to rely on the commercial general liability (CGL) insurance policy and liability coverage that it purchases to cover construction defects. Nevertheless, under the current interpretation of occurrence, an owner cannot rely on such protection since defective design or construction work does not trigger coverage.

Amicus curiae respectfully request this Court to interpret CGL insurance policy language so that construction defects are an "occurrence" that trigger indemnity and defense obligations of insurance carriers typically included in CGL policy language. Such a reasonable interpretation would benefit those entities involved in the construction process, including construction contractors, subcontractors, owners, and particularly the State of Mississippi, its agencies, and local and municipal entities that are responsible for public works projects as owners that represent all Mississippi residents.

The term "occurrence" should be interpreted as an accident that includes continuous or repeated exposure to substantially the same harmful conditions. Negligence that results in a construction defect should reasonably be considered an occurrence related to an accident (that produces unexpected and unintended results) involving continuous or repeated exposure to the same general harmful conditions created by the defect. The current interpretation of occurrence has nothing to do with the intentional act of hiring a subcontractor. The definition of occurrence and the "expected or intended injury" exclusion policy language, common in CGL policies, mandates that coverage is inapplicable to bodily injury or property damage that is expected or

intended. See *United States Fidelity & Guaranty Company v. Omnibank*, 812 So. 2d 196 (Miss. 2002). However, a construction defect that may involve property damage or bodily injury cannot reasonably be considered expected or intended injury (although such defect could lead to an expected injury) and should not be excluded from coverage. The hiring of one or more subcontractors by a general contractor for contractual design or construction work is clearly an intentional act but one not reasonably contemplated by the policy exclusion for expected or intended injury.

General contractors have a duty to select qualified subcontractors but should also be confident they are covered by a CGL insurance policy when construction defects occur. That assurance logically is the basis and the reason for obtaining such coverage in the first place. CGL carriers can and should account for this possibility in their rate quotation to contractors and owners.

The State of Mississippi has been forced in the past and will be forced in the future, to the detriment of its own citizens and taxpayers, to suffer and continue to suffer financially at the cost of millions of dollars due to adverse and conflicting interpretations by the courts of the term "occurrence" under a CGL policy. An occurrence under such policy must reasonably relate to an accidental situation (as well as to negligence-based defects) including continuous exposure to at least one harmful condition (such as a defect) in construction and not to an intentional act to subcontract or to construct.

The current interpretation by certain courts, including the circuit court in this instance, has and will continue to adversely and detrimentally affect the costs of public facility construction and repair of construction defects of public facilities in Mississippi and further increase those costs to its citizens. A construction defect caused by an insured contractor that

damages other property or work and a defect caused by a subcontractor can and should be reasonably interpreted as an occurrence that triggers coverage under a CGL insurance policy. Such damage may typically occur well after the facility has been occupied and initially utilized for its intended purpose and after the performance bond period has expired.

III. Current interpretations of an occurrence under CGL insurance policies have and will continue to adversely affect the State's interests.

A recent actual case is illustrative. See *State of Mississippi ex rel. Attorney General Jim Hood, et al. v. The Johnson-McAdams Firm, P.A., et al.*, Leflore County Circuit Court Civil Action No. 2005-0071-CICI. The State of Mississippi was forced to consider accepting a much-reduced settlement amount through mediation for damages due to design and construction defects (including serious water intrusion and extensive mold and mildew growth) at the newly-constructed Sutton Administration Building at Mississippi Valley State University in Itta Bena, Mississippi. All building offices and occupants had to be relocated to leased facilities brought to campus. Moreover, the State of Mississippi was forced to bear the costs to investigate the defects, pay for building redesign, and pay for all building reconstruction and remediation. The CGL carrier refused to cover the contractor. The State could have pursued its claims in court for damages due to architect, contractor, and subcontractor negligence. However, that choice meant enormous risk for the State in that it stood very likely to obtain little or nothing from the defendants, who admittedly faced bankruptcy and litigation fees that would have entirely depleted what small settlement amount was offered had the process matured completely through trial. The State's reluctant decision to settle for a fraction of its damages then rather than little or nothing later was due to the insurance carrier's refusal to cover its insured under the standard

Insurance Services Office (ISO)-adopted CGL policy that the insured had purchased for the construction project. The insurer relied on a Fifth Circuit Court of Appeals opinion in its refusal to cover the insured, resulting in the State settling for a small portion of its damage claims rather than risking the probability of obtaining nothing after trial, even if the State had been completely successful in proving architect and contractor liability and all damage amounts. See *ACS Constr. Co., Inc. of Mississippi v. CGU*, 332 F.3d 885 (5th Cir. 2003). The State of Mississippi suffered a huge financial loss due to construction defects and the costs of its investigation, facility redesign, facility reconstruction, occupant relocation and temporary facility rentals, and litigation based on the insurance carrier's refusal to cover its insured under the CGL policy and its judicially-sanctioned interpretation of an "occurrence" under the policy.

A hypothetical example of yet another unfathomable result is where a general contractor and/or subcontractors construct a state-owned building which is occupied soon thereafter. Subsequently, the building unexpectedly collapses due to allegedly negligent construction work and injures or kills multiple occupants. In such a hypothetical case, a CGL insurer could apparently successfully refuse to cover the insured under the same type of CGL policy since the insurer could claim that no occurrence existed and no duty to defend its insured was triggered to cover the owner's property damage or any claimant's bodily injury.

Moreover, assume construction defects were to appear in the new Mississippi Supreme Court building subsequent to completion and occupation. Such defects could cause damage to the facility and/or its contents that could be found to be due to contractor or subcontractor negligence. Under the current interpretation of "occurrence" within the same type of CGL policy, and one that the State requires an insured contractor to obtain, coverage would be worth nothing since no "occurrence" would exist to trigger coverage as such defects and damages

would not constitute an occurrence under the policy. This result would likewise be detrimental to the State of Mississippi since absolutely no coverage or protection of the State would exist.

Absolutely no incentive for negotiation and purchase of such insurance coverage exists if similar situations involving construction defects do not trigger coverage under a CGL insurance policy. Insured owners, and particularly the State of Mississippi and all local and municipal entities as owners, that rely on such CGL insurance coverage have no reason whatsoever to negotiate and pay for such coverage since the law shifts the entire risk of construction defects and repair costs therefor to the contractor (and owner) and completely away from the insurer. The insurer bears little, if any, risk of loss since an occurrence (for construction defects) under such policy has been interpreted as not triggering coverage. Construction defects could include, but would not be limited to, water intrusion and mold and mildew that damage a building or defect damages due to faulty construction of roads, bridges, and other facilities owned by the State. Both private and public owners, including the State of Mississippi, developers, contractors, and subcontractors have been and will continue to be seriously adversely and financially affected if this Court continues the current interpretation of an occurrence under a CGL policy when construction defects are at issue.

As mentioned, contractors of public projects for the State of Mississippi are generally required to obtain CGL coverage to protect the project owner in the event of property damage or bodily injury due to acts by contractors or subcontractors. Owners including the State clearly rely on such insurance coverage. However, their reliance is apparently misplaced since CGL policy coverage for construction defects is of no value when construction defects occur and policy coverage is denied by the insurer and the courts. Moreover, insurers continue to accept premiums for CGL coverage paid to them, but bear little if any risk of exposure or of ever paying

one cent for such defect damage. Also as mentioned, since subcontractors are typically hired by general contractors for specialty construction work, a clear incentive exists for owners, and particularly the State, to rely on construction defect coverage. However, no recourse exists for the State (and private owners) when construction defects occur and have to be resolved. The only real option is to litigate with the contractors who in turn will litigate with their subcontractors, while neither of whom will be very likely to afford the potentially large litigation costs or the costs of defect repair, as is the case for the Appellant in the present appeal. The result is that the State is left with little or nothing. Private and public facility owners must apparently negotiate and pay premiums for such valueless insurance coverage through contract bids AND then must also bear the entire risk of liability and pay for investigation, redesign, repair and reconstruction, and relocation costs when a construction defect manifests itself and has to be addressed. Resolution of property and personal injury damages due to construction defects under a CGL policy should be reasonably interpreted such that owners are not left bearing all risk and left with no recourse to rectify defective construction. A logical interpretation that negligent work resulting in defective construction is in fact an occurrence covered under a CGL insurance policy would properly protect the State of Mississippi, insured contractors and subcontractors, and other facility owners when defective construction results in damage or injury to property or individuals. Under the current interpretation of what constitutes an occurrence under a CGL insurance policy and to the sole benefit of the insurers, the State of Mississippi and other facility owners and contractors and subcontractors continue to be under an enormous risk of further irreparable damage by such an unreasonable interpretation.

CONCLUSION

For the reasons briefly outlined herein, the State of Mississippi submits that this Court should reverse the decision of the Circuit Court and grant the relief requested by the Appellants by finding that negligent contractor or subcontractor construction defects that result in property damage or bodily injury are considered occurrences and are covered under a CGL insurance policy.

Respectfully submitted,

MISSISSIPPI DEPARTMENT OF FINANCE AND ADMINISTRATION, BUREAU OF BUILDING, GROUNDS AND GROUNDS, AND REAL PROPERTY MANAGEMENT, MISSISSIPPI INSURANCE DEPARTMENT, MISSISSIPPI DEPARTMENT OF TRANSPORTATION, AND THE STATE OF MISSISSIPPI

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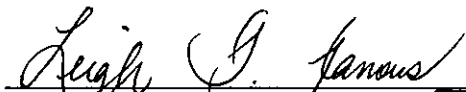
BY: 

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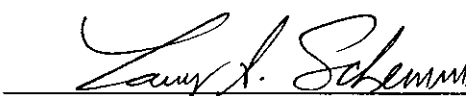
BY: 

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We, Leigh T. Janous and Larry A. Schemmel, do hereby certify that a true and correct copy of the above and foregoing Brief of Amicus Curiae has been sent via U.S. Mail to the following:

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