IN THE SUPREME COURT OF MISSISSIPPI

ARCHITEX ASSOCIATION, INC. — APPELLANT

V. — NO. 2008-CA-01353

SCOTTSDALE INSURANCE COMPANY — APPELLEE

Appeal from the Circuit Court of
Rankin County, Mississippi
Twentieth Judicial District

REPLY BRIEF OF APPELLANT

ORAL ARGUMENT REQUESTED

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RESPONSE TO APPELLEE'S STATEMENT OF THE FACTS

Scottsdale Insurance Company's ("Scottsdale") Statement of Facts contains several inaccurate statements that compel a response from Architex Association, Inc. ("Architex"):

1. Scottsdale states: "For more than two years, Architex litigated the case without any notice to Scottsdale of the claims, lawsuit or arbitration." (Appellee Br., p. 3). Although *the trial court expressly made no ruling on Scottsdale's notice argument* (R. at 3020; MRE 3) and, therefore, this statement is irrelevant, any implication that Scottsdale was not provided prompt notice of the Owner's allegations against Architex is simply inaccurate and disputed.[1] The first covered claim -- an allegation of insufficient rebar -- was not made by the Owner until September 30, 2004 (Vol. 1, Ex. 6 at 18; RE 31), two years after the litigation was commenced, and a year and a half after the litigation was stayed for arbitration. Scottsdale was provided notice of the Owner's rebar claim ***six days*** after Architex was informed of the claim. (Vol. 1, Ex. 6 at 18; RE 31).

2. Scottsdale states: "Architex did not provide a copy of the complaint with the Acord form." (Appellee Br., p. 3). This statement is so outlandishly misleading that we feel compelled to respond. First, Scottsdale *was* provided a copy of the complaint on November 4, 2004. (Vol. 4, Ex. 4 at 18-19; RE 33). Second, the complaint was irrelevant because, pursuant to court order (R. at 105-107; RE 32), the matter was referred to arbitration in March 2003. The parties were not in litigation when the Owner made its claim a year and a half later, on September 30, 2004. (Vol. 1, Ex. 6 at 18; RE 31).

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[1] Since Scottsdale's own expert testified that notice was not an issue in this case (Vol 4., Ex. 17 at 243, 245, 249; RE 18), it is surprising that so much of the Appellee's Brief is devoted to notice. The trial court expressly stated that it was not making a ruling on Scottsdale's notice claim, and the issue is not on appeal. Moreover, since the underlying action has been stayed and there has been no outcome, it is impossible for Scottsdale to show that an outcome would have been radically altered had Scottsdale received notice earlier, as required under *Capital City Ins. Co. v. Ringgold Timber Co., Inc.*, 898 So. 2d 680, 682 (Miss. Ct. App. 2004) (cert. denied).

3. Scottsdale states: "Prewitt eventually provided a copy of the complaint but informed Scottsdale it was a 'courtesy copy.'" (Appellee Br., p. 3). Again, this issue is not on appeal, but the statement is false. Scottsdale's suggestion that Architex was providing claim information to Scottsdale but asking Scottsdale to do nothing is not true. Prewitt's letter to Scottsdale dated November 4, 2004, referred to the "very recent rebar problem" and included a copy of the complaint, Architex's answer, and "Mr. McCrory's letter of October 26, 2004 raising these allegations." Prewitt's letter also states that he "*will be happy to furnish such information as you need in order to make the decision that Scottsdale should provide a defense on at least this issue.*" (Vol. 4, Ex. 4A; RE 19)(Italics added).

4. Scottsdale states: "Scottsdale was not requested to defend Architex against the complaint, but only against the purported rebar issue (of which no mention was made in the complaint)." (Appellee Br., pp. 3-4). The claim was made in arbitration. Litigation had been stayed for a year and a half, and there was no "complaint" to defend against. Architex was clearly requesting a defense to the insufficient rebar claim being made in arbitration. By letter dated November 22, 2004, Prewitt again requested Scottsdale's help:

> *I have a lot of information concerning this issue and will be happy to share it with you if requested. We need Scottsdale's help to attack this issue and will appreciate you help in that regard.*
>
> I fully expect the owner to amend its demand in the arbitration to include a demand for the total loss of the building, etc. which the Owner claims to be an additional $2,000,000 plus loss of profits, etc.
>
> *Please help us on this.*

(Vol. 4, Ex. 4, Ex. 4B; RE 34)(Italics added).

5. Scottsdale states: "Following receipt of the Acord form, the independent adjusting company of Crawford & Company ("Crawford") was assigned to investigate the rebar claim." (Appellee Br., p. 3). This statement is false according to Crawford and *false even according to*

Scottsdale. Crawford was hired for one purpose, and only one purpose--to get a statement from Vic Hamby, the president of Architex.[2] (Vol. 1, Ex. 11 at 27, 32, 34-35, 41-43, 75-80; RE 11). First, the relevant part of Crawford's 30(b)(6) deposition:

> Q. ... So your only task was to get a recorded statement?
>
> A. Correct.
>
> Q. And that was it?
>
> A. That was it.
>
> Q. *You were not to investigate the claim?*
>
> A. *No.*
>
> Q. You were simply -- you, being Crawford & Company was simply contacted to get a recorded statement?
>
> A. Correct.
>
> • • •
>
> Q. In this case, they didn't ask you -- they being Scottsdale -- did not ask you to get an appraisal of the damage, did they?
>
> A. No.
>
> Q. They didn't ask you to get a photograph of the damage, did they?
>
> A. No.
>
> Q. They didn't ask you to interview any witnesses other than the insured; is that correct?
>
> A. Correct.
>
> Q. And they didn't ask you to obtain any documentation from the insured or the attorneys?
>
> A. No.
>
> . . .

[2] Since Architex's on-site supervisor was Mr. Larry Bielski and Hamby's involvement was only as an investor and officer, even this lone assignment was unhelpful.

> Q. And this -- page 11, it's a "Fax Assignment-General Liability," and it's got "Independent Adjustor," and it's got 14 different things -- I guess -- I'm sorry -- 18 different tasks that could be assigned, and there is one marked; is that correct?
>
> A. Correct.
>
> Q. And that just says, "Statement from: Insured Victor Hamby"?
>
> A. Correct.
>
> Q. Okay. So as you appreciate it, *that was your only assignment; is that right?*
>
> A. *Correct.*

(Vol. 1, Ex. 11 at 32, 34-35, 41-43; RE 11)(Italics added). Even Scottsdale's representative also testified that the only task was simply to get a statement from Hamby:

> Q: What's your understanding about what was requested of Crawford & Company?
>
> A: That they obtain a statement from Mr. Hamby.
>
> Q: And so they were -- and is that your understanding, that that was the only task that they were assigned?
>
> A: At that point, yes.
>
> Q: At that point. Were they subsequently assigned other tasks?
>
> A: To my knowledge, no.
>
> Q: Okay. *So their one and only assignment, as far as you know, is to get a statement from the insured, Vick [sic] Hamby*?
>
> A: *Correct.*

(Vol. 2, Ex. 15 at 320-21; RE 35)(Italics added). Scottsdale did not conduct any investigation, and neither did Crawford.

6. Scottsdale states, "Prewitt told Scottsdale's claim representative that plaintiffs were no longer pursuing the rebar issue and Scottsdale was not required to provide a defense," and also claims that it received "April 22, 2005 advice from Architex that it was not seeking a

defense against the hotel owners' claims, ..." (Appellee Br., p. 4). These statements are directly contrary to Prewitt's Affidavit (Vol. 4, Ex. 4, Ex. 4 at ¶7; RE 36) and Prewitt's recollection:

> Q: . . . in our conversation, and in your affidavit, you told me that at no time did you instruct Crawford & Co. or Scottsdale to close the file; is that correct?
>
> A: That's absolutely correct, and if they say otherwise, they -- I mean, I don't practice law like that. I would never give up.
>
> Q: And it's your understanding through your letters, which I think specifically you asked for a defense and, in your conversations, it's your understanding that you were asking for a defense and, in fact, Scottsdale understood that request?
>
> A. (after objection) I don't know what Scottsdale understood. I tried to make them understand, yes...and in fact, I invited their representative to have a lengthy discussion with Mr. Bielski at his convenience and said I'll arrange it, and he could come by here and look at all of this 20 boxes of stuff I had, and he didn't take me up on that. He laughed and didn't take me up on that.

(Vol. 4, Ex. 4 at 44; RE 37).

> Q: Mr. Prewitt, did you ever tender the defense of the Parshotham lawsuit to Scottsdale?
>
> A: Yeah, certainly, I did . . . That was the whole purpose of getting them contacted concerning negligence claims or the claims that were going to be made and were being generated at the time, both intentional and negligent claims generated by [the Owner's attorneys], and that was, as I understood, the entire purpose was to get them activated to defend those claims, and as the other allegations surfaced, having them take over these claims, sure. Does Scottsdale deny that?
>
> Q: Yes sir.
>
> A: Okay. They would be wrong.

(Vol. 4, Ex. 4 at 36-37; RE 38). Prewitt is correct; Scottsdale is wrong. Scottsdale's extensive denial of notice in its Brief further demonstrates its bad faith. It serves no other purpose. There is no ruling on notice and it is not on appeal.

SUMMARY OF THE REPLY ARGUMENT

Architex requests that this Court reverse the Rankin County Circuit Court's entry of summary judgment against it, thereby recognizing that Scottsdale's interpretation of *Omnibank* is not correctly applied to this case involving unintended, defective work of a subcontractor that causes injury to persons or property. In reply to Scottsdale's Response Brief, Architex states:

(1) There is coverage under the plain meaning of the policy language for damage to the Completed Project caused by a subcontractor's defective work. A view of the entire policy and literature from the insurance industry itself demonstrates the drafter's intent to cover claims for this damage. The alternative is a decision that effectively strips contractors of any insurance protection for defective subcontractor work and renders other key components of the policy meaningless.

(2) Although the trial court declined to rule on the issue of notice and that issue is not before this Court on appeal, the conditions precedent to triggering Scottsdale's duty to defend under the policy have been triggered, including notice. Architex timely notified Scottsdale of allegations of insufficient rebar and mold and mildew.

(3) Scottsdale has breached the duty to investigate, the duty to defend, and the duty to act in good faith and fair dealing; and has exhibited bad faith behavior that, even if there is ultimately found to be no coverage under the policy, cannot survive the scrutiny of previous decisions from this Court, including *Bankers Life & Cas. Co. v. Crenshaw,* 483 So.2d 254 (Miss. 1985) and *Andrew Jackson Life Ins. Co. v. Williams*, 566 So. 2d 1172, 1188 (Miss. 1990).

ARGUMENT

Imagine this:

One Monday morning, you get into your car to drive to work. You kiss your spouse, drive down your street, out of your neighborhood, and onto a highway. Just before the office, you are momentarily distracted by the ringing of your cell phone. You run a red light and plow into the side of an oncoming car. The other driver is taken to the hospital. Thankfully the driver recovers but only after incurring $30,000 in medical bills and suffering substantial loss of wages.

After the crash, you call your insurance company to let them know that you have been involved in an accident and expect to be sued by the other driver. The insurer asks you if you intended on driving your car that morning.

You explain that you were on your way to work. Of course, you intended to drive your car, but did not intend to hit the other driver. The insurer responds that the policy only covers accidents or occurences, and that you are not insured for your "intentional" act.

You respond that you purchased the policy for the express purpose of covering damage caused by car wrecks just such as this. The insurer responds that in Mississippi, under *Omnibank*, your intentional act of driving was a "course consciously devised and controlled by" you, which undeniably set in motion the "chain of events leading to the injuries complained of." (Appellee Br., p. 13).

This scenario sounds crazy, right?

This is the expansive interpretation of *Omnibank*[3] that Scottsdale asks this Court to apply to damages caused by a subcontractor's inadvertent construction defect, unintended from the standpoint of the insured general contractor. According to Scottsdale, the only question is whether the general contractor intended to subcontract the work. If so, according to them,

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[3] *United States Fid. & Guar. Co. v. Omnibank*, 812 So.2d 196 (Miss. 2002).

everything that happened after the intentional subcontracting is intentional, and there is no accident or occurrence under the policy. The remainder of the policy is disregarded.

This is not the law under *Omnibank*. This is not the law under *ACS*.[4] To reach this conclusion, Scottsdale misinterprets this Court's decision in *Omnibank* and flatly misstates both the facts and the holding of the Fifth Circuit's decision in *ACS*. If this Court follows the crooked road laid out by Scottsdale it will mean that Mississippi contractors, unlike contractors in other states, have no coverage for damage to a completed project caused by the negligent act of a subcontractor.[5] There is no reason that contractors in Mississippi should not get the full coverage provided by their policies.

To apply *Omnibank* in the unreasonably expansive manner suggested by Scottsdale would ignore the practical effect this ruling will have on general contractors, subcontractors, banks, owners (public and private), and others who count on the protection of Commercial General Liability ("CGL") policies on completed construction projects in Mississippi. This Court has the opportunity to rightfully decide that insurers must honor the policies they have marketed to contractors, and hold that defective subcontract work triggers coverage for completed operations under the clear intent of the policy language. Correctly interpreting the application of these CGL policies will have a stabilizing effect on the construction industry in this State. This is why Architex is joined in this case by the State of Mississippi, the Mississippi Department of Finance and Administration, the Mississippi Insurance Department, the Associated General Contractors of America, the Associated General Contractors of Mississippi,

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[4] *ACS Const. Co. v. CGU*, 332 F.3d 885 (5th Cir. 2003).

[5] Consider the seriousness of this problem. Subcontractor work will not be covered by any insurance policy. Builders Risk Insurance and Performance Bonds do not apply to completed operations. The subcontractors work is generally not covered by its own policy because of the "your work" exclusion. The insurance industry developed the products completed operations coverage and the subcontractor exception to the "your work" exclusion for the very purpose of filling this gap.

the American Subcontractors Association, the American Subcontractors Association of Mississippi, and the Mississippi Asphalt Paving Association. These parties are painfully aware of the uncertainty and confusion created by the misinterpretation of *Omnibank* and *ACS*. This confusion must be resolved, and resolved in favor of the insureds.

I. Any defective subcontractor work was an accident or occurrence unintended by the general contractor Architex, and the "Intentional Acts" exclusion does not apply.

The problem with Scottsdale's argument is a failure to appropriately diagnose the "act" that leads to an occurrence and directly causes the damage. What was Architex's "intended" activity that takes the damage to the building out of the realm of an "accident" or "occurrence", or that activates the "Intentional Acts" exception to coverage? As articulated by Scottsdale's counsel, *Architex's intentional act was simply hiring subcontractors to perform work.* Scottsdale is focusing on the incorrect "act." Under *Omnibank*, Scottsdale and the Court should be inquiring as to whether Architex intended to malperform any of the construction work which damaged the building and its contents. In other words, did Architex intend to improperly install rebar or to knock off a false chimney? These are the acts that led to the damage. These acts were not intentional.

The fact that Architex intentionally hired a subcontractor is entirely irrelevant -- just like it is irrelevant that a driver intended to drive a car. The question is not whether the driver intended to drive the car; it is whether the driver intended to hit the other car. The sheer absurdity of Scottsdale's position is demonstrated best by its own argument at the summary judgment hearing:

> Now, Mr. Carson said . . . that Scottsdale has no evidence that these acts are intended from the standpoint of the insured. Well, sure we do, Judge, and the facts are these:
>
> Architex entered into a construction contract to build a hotel for the owners in Pearl. Architex intended to discharge its contractual obligations through the use of subcontractors. Architex

> affirmatively elected to do so, your Honor. *The use of subcontractors by Architex to build the hotel was no accident. They affirmatively elected to do it, and they went on and did it.*

(Vol. 23 at 189; RE 39)(Italics added). Counsel continued:

> Your Honor, we deposed -- took the 30(b)(6) deposition of Architex. Victor Hamby, who is sitting here today, was the deponent. I asked him: "And as the general contractor on the project, what was Architex going to do?" Answer: "We were responsible for building the County Inn & Suites in Pearl, Mississippi, procuring the subcontractors to perform the tasks necessary to complete the contract."
>
> *Your Honor, that was not accidental; it was not unintended.*

(Vol. 23 at 190; RE 39)(Italics added). According to Scottsdale, the very act of hiring a subcontractor mandates that there is no occurrence:

> MR. SHELSON: . . . [Architex] went out and hired [subcontractors] and then they supervised them.
>
> THE COURT: But they didn't hire them to do crappy work.
>
> MR. SHELSON: But, your Honor, they hired them to do the work, and the fact that you look -- that goes back to this your Honor, we submit. We submit the Court has to look at the nature of the insured party's conduct, not the resulting damages. *So the issue was whether they hired them to do the work, which is indisputably yes, not whether the work resulted in any damages.*

(Vol. 23 at 195; RE 39)(Italics added).

This is nonsense. The end result of this argument is that if the insured is engaged in the very business for which it sought insurance, it is not insured. Nevermind that there is no allegation that Architex was in any way negligent in hiring or supervising its subcontractors. Forget that Architex purchased a policy that specifically covers subcontractor work. As articulated by Charles Roberts, Scottsdale's agent to Architex, in his words: "to defend the general contractor in the case that suit is brought against him because of the acts of his subcontractors." (Vol. 3, Ex. 3; RE 15). Nevermind that Scottsdale's insurance application is specifically for construction, and that Architex purchased the insurance policy precisely for that

purpose. (Vol. 1, Ex. 2; RE 1). Forget that the application specifically asks for the amount of work performed by subcontractors, to which Architex correctly stated to be 100%. (Vol. 3, Ex. 6; RE 17). Are we to assume that the CGL policy now only covers the acts of subcontractors that were *unintentionally* hired by the contractor? If so, how does one unintentionally hire a subcontractor?

Scottsdale's interpretation of *Omnibank* by defining the underlying act as subcontracting is ridiculous and is why so many associations and public entities have filed amicus briefs in support of Architex. These amici recognize that Scottsdale's expansive interpretation of *Omnibank* (and its CGL policy) creates chaos in the construction industry. Although this particular case involves property damage alone and not bodily injury, the overly expansive *Omnibank* interpretation Scottsdale uses would apply to both types of damages. There is no question of where Scottsdale's road leads. Indeed, rather than risk being accused of being "misleading" again by Scottsdale or "misstating" the record (Appellee Br., pp. 19-24), there is no better articulation of Scottsdale's argument than by its own counsel:

> THE COURT: . . . In other words, I don't think Architex could in any way be construed -- or at least I haven't heard any suggestion that they purposely picked subs that were crappy and didn't know what they were doing, and they didn't intend for those subs to build stuff in a bad manner, and so the result, if a wall fell on somebody or the damage was to the work itself, is not what I look at.
>
> But if I followed your logic, then *Scottsdale wouldn't have any obligation if in fact the whole hotel collapsed and killed a hundred people sleeping in their beds, and that could be traced back to this bad rebar claim.* You're saying no coverage. They wouldn't have any coverage. Scottsdale wouldn't have to cover that.
>
> MR. SHELSON: *Yes, sir.* I'd say two things in response. ***First, I'd submit that that's not my interpretation; that's the Supreme Court's interpretation. And, second, I'd agree with you that under the holding of Omnibank there would be no coverage.***

(Vol. 23 at 199; RE 39)(Italics and bold added).

The Mississippi Supreme Court has never even come close to interpreting *Omnibank* or a CGL Policy in this absurd manner. By the admission of Scottsdale's own expert, Scottsdale's interpretation of occurrence would be "problematic" and "too narrow."[6] (Vol. 4, Ex. 1, at 8-9; RE 40). In effect, Scottsdale recognizes that its interpretation deprives the insured of the coverage stated in the policy and blames this not on itself but on *this* Court.

There is nothing in *Omnibank* that remotely suggests the illogical conclusion that *any* intentional act, no matter how remote, dictates that there has been no "accident" or "occurrence," or activates the "Intentional Acts" exclusion. The simple answer is that *Omnibank* is good law that has been misapplied by Scottsdale. The relevant act is not simply subcontracting. Rather, the "act" in this case is improperly placing rebar and knocking off a false chimney (which led to water damage to the Project). These acts were accidental, not intentional. This is how these policies are interpreted in Texas[7] and Florida[8], along with a vast majority of other states, and it is unfathomable to think that this interpretation applies to contractors in high-volume construction states but cannot have the same enforceability in a state which needs contractors to rebuild in the wake of the most devestating natural disaster in this nation's history. Without proper interpretation of these policies, contractors, public and private owners, lenders and innocent third parties are at risk of being unprotected from personal injury and property damage caused by subcontractor negligence.

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[6] Likewise, although the trial court ultimately agreed with Scottsdale's interpretation of *Omnibank*, the court also acknowledged that this interpretation "may be strict, harsh, and too narrow, as Architex and some commentators would argue." (R. at 3019; MRE 3).

[7] *Lamar Homes v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007).

[8] *United States Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007).

II. Faulty subcontractor work is covered for Completed Operations.

Scottsdale has misstated both the facts and holding of *ACS*. Scottsdale states in its brief and argued to the trial court that *ACS* is a third-party insurance case just like this one. It is not. *ACS* was a first-party case. ACS sought first-party coverage for its own cost in correcting work performed by a subcontractor during ongoing construction. *ACS*, 332 F.3d at 887. Scottsdale states that "*ACS* was sued for the defective installation of roof membranes by one of its subcontractors." (Appellee Br., p. 10). This is not true. The construction project was not completed and ACS was never sued. The Products-Completed Operations Hazard portion of the policy was not an issue in *ACS* as it is here. The Fifth Circuit found that *ACS* should have procured a performance bond to protect itself from its subcontractor's failure to perform during construction. *Id.* at 892.

That is an entirely different scenario. This is a third-party case. Architex was sued by the owner for damage to the *completed* Project. A payment bond would not cover this situation, but the Products-Completed Operations Hazard of the policy does. *ACS* does not apply here and Scottsdale's reliance on it is incorrect and misleading.

The history of the policy language leaves no doubt as to the correct decision by this Court. In response to industry concern, insurance companies began offering Broad Form Property Damage ("BFPD") coverage for the risk of damage to otherwise non-defective work resulting from defective subcontractor performance. Materials circulated by the insurance industry emphasized that the BFPD endorsement provided coverage to general contractors for losses arising out of subcontractor work. For example, a circular prepared by the Insurance Services Office ("ISO") explained that "[t]he insured would have coverage for damage to his own work arising out of a subcontractor's work [and] [t]he insured would have coverage for damage to a subcontractor's work arising out of the subcontractor's work." (R. at 2977; RE 41).

After BFDP was adopted by ISO, a hypothetical ***conceived by the insurance industry itself to sell BFPD coverage*** neatly frames the issue before this Court:

> An example of how exclusion (1.) [Damage to Your Work] could apply is as follows. The named insured is a general contractor who has built an apartment house with the services of numerous subcontractors. After the building is completed and put to its intended use, a defect in the building's wiring (put in by a subcontractor) causes the building, including work of the general contractor and other subcontractors, to sustain substantial fire damage. The named insured is sued by the building's owner. Although the named insured's policy excludes damage to "your work" arising out of it or any part of it, the second part of exclusion (1) makes it clear that the exclusion does not apply to the claim. That is because the *work out of which the damage arose was performed on the named insured's behalf by a subcontractor.* * * * Thus, barring the application of some other exclusion or adverse policy condition, the loss should be covered, including the part out of which the damage arose.

See O'Shaughnessy v. Smuckler Corp., 543 N.W.2d 99, 105 (Minn. Ct. App. 1996)(citing *Fire, Casualty and Surety Bulletins*, Aa 16-17 (The National Underwriter Co. 1993)). Did the contractor in the hypothetical above intend to hire the subcontractor? Yes. Is that relevant? No.

Since there continued to be confusion about the extent of coverage provided under the BFPD endorsement, in 1986, ISO included coverage as part of its standard form basic insuring agreement for general liability policies, now the same CG 00 01 policy form. This is the very form used and marketed by Scottsdale here. (Vol. 1, Ex. 2; RE 1). While the ISO forms have continued to evolve since 1986, the BFPD coverage language has remained the same.

Indeed, any confusion over the scope of coverage provided by ISO forms arises out of a failure to recognize the critical changes in the policy language over the past three decades. Litigation is a search for the truth, and this Court should not ignore this crucial opportunity to correctly determine the parties' intent in entering into such an important insurance form contract. The only reasonable conclusion, in view of the history of the language and its use in the industry, is that the third-party allegations against Architex constitute an occurrence and are covered under the Products-Completed Operations Hazard coverage of the policy.

III. The Court must give meaning to all the terms of the contract.

Mississippi law favors a contractual interpretation that reads the contract as a whole, considering all the relevant portions together and "whenever possible, shall give operable effect to every provision in order to reach a reasonable overall result." *J.W. Foods Corp. v. State Farm Mut. Auto Ins. Co.*, 723 So.2d 550, 552 (1998). This rudimentary rule of contractual interpretation is important, because to apply *Omnibank* as broadly as Scottsdale suggests would be to effectively throw out the remainder of the policy, including the many provisions developed by the industry to insure that certain events beyond the control of the insured-contractor are covered. The "your-work" exclusion (and the subcontractor exception to that exclusion), the completed operations exclusion, and recognized exclusions for mold and subsistence (there is no mold exclusion in this policy), are all relevant to this Court's analysis in formulating the parties' intent in adopting the policy.

Scottsdale has espoused the tired "exclusions do not create coverage" theory in its brief as if Architex relies on the same. (Appellee Br., p. 22). All Architex asks is that this Court look to the language of all provisions of the contract to interpret the meaning of the coverage language in the policy. A most recent Fourth Circuit opinion succinctly addresses the compelling reason for considering the entire document, including exclusions, in interpreting the term "occurrence":

> The "your work" exclusion excludes coverage for damage that the insured might cause to its own work, but exempts from that exclusion any damage that an insured's subcontractor might cause to the insured's work. The *Miller* court rejected the argument that exclusions "create" coverage. 142 Fed.Appx at 149. Although this is a valid point, it misses the mark slightly. The import of the "your work" exclusion and its subcontractor exception is not that the exclusion "creates" coverage. Rather, the import is that the exception lends insight into the baseline definition of "occurrence" from which parties and courts interpreting CGL policies should operate. If the definition of "occurrence" cannot be understood to include an insured's faulty workmanship, an exclusion that exempts from coverage any damage the insured's faulty workmanship causes to its own work is nugatory. If, on the other hand, the definition of "occurrence" does include an insured's faulty workmanship, such an exclusion functions as a meaningful "limitation or restriction on the insuring clause." *Nationwide Mut. Ins. Co. v.*

> *Wenger,* 222 Va. 263, 278 S.E.2d 874, 876 (1981) (quoting *Haugan v. Home Indem. Co.,* 86 S.D. 406, 197 N.W.2d 18, 22 (1972)).

Stanley Martin Companies, Inc. v. Ohio Cas. Group, 313 Fed.Appx. 609, 613, 2009 WL 367589, *3 (4th Cir. 2009). Despite Scottsdale's claim to the contrary, these all-but-forgotten provisions do have meaning. They provide the basis for interpreting the policy and determining the intent of the policy. The "subcontractor exception" to the "your-work" exclusion demonstrates the intent that property damage caused by the work of a subcontractor *is* intended to be an occurrence under the policy. The products-completed operations provision demonstrates that defects in the work after the operation is completed are likewise occurrences and covered.

If interpreted properly by giving meaning to the "whole" of the contract, the *Omnibank* decision fits well within the framework created by the standard CGL policy at issue in this case. The succinct ruling in *Omnibank* is as follows:

> [T]he only relevant consideration is whether, according to the declaration, the chain of events leading to the injuries complained of were set in motion and followed a course consciously devised and controlled by [the insured] without the unexpected intervention of any third person or extrinsic force.

Omnibank, 812 So.2d at 200. Architex's subcontractors' alleged actions are not "consciously devised and controlled by [the insured] without the unexpected intervention of any third person." *Id.* This particular situation is fully taken into account by the CGL policy in question by virtue of the subcontractor exception to the "your work" exclusion. The subcontractor act of knocking off a false chimney which allowed water intrusion, or improperly installing rebar which caused structural damage, was not consciously controlled by Architex and was not intentional. To the very contrary, these negligent acts were wholly unexpected and unintended by Architex. In fact, Architex had built several other hotels using this subcontracting method, all of which turned out well. Architex purchased insurance from Scottsdale to cover such occurrences and has been flatly denied the benefit of its bargain.

Further, the Policy excludes coverage for damage to the insured's work, but specifically excepts "property damage" included in the "products-completed operations hazard" and work performed by a subcontractor. (Vol. 1, Ex. 2; RE 1). In this case, the ***actions*** of the third-party subcontractors create the occurrence, not their hiring. Architex fully expected its subcontractors to perform their work according to their subcontracts, according to the specifications provided them, and in a good and workmanlike manner. Scottsdale has produced ***absolutely no evidence*** whatsoever that Architex knew or should have known of the alleged negligent actions of its subcontractors and has produced no evidence that Architex intended for its subcontractors not to perform properly. As such, a negligent, accidental or even an intentional act by a third-party subcontractor was not intended from the standpoint of the insured general contractor Architex, and therefore amounts to an occurrence under the policy. Thus, *Omnibank* and the CGL policy are consistent and demonstrate that alleged negligent actions of third-party subcontractors is not the work of Architex and is therefore an accident from the perspective of the insured. Moreover, under the subcontractor exception to the "your work" exclusion and the products completed operations hazard, this occurrence is not excluded and is covered by the policy.

In *ACS*, the only damage was to the subcontractor's work itself, and not the overall Project. Scottsdale's Brief on this point is confused. *ACS* was a first party case. ACS wanted its insurer to pay for the replacement of the subcontractor's work (the waterproofing). There was no damage to other work on the project and completed operation coverage was not in issue because the project was ongoing. This case is different: (1) the project is completed and thus the Project-Completed Operations Hazard coverage applies; (2) this is a third-party case -- Architex has been sued by the owner and seeks defense to claims of damage to the Project; and (3) there is damage to the overall Project not just damage to a subcontractor's work. For all these reasons, *ACS* is not applicable. If Scottsdale has relied on *ACS*, it has done so to its detriment.

IV. The trial court expressly declined to rule on Scottsdale's alternative argument regarding notice, and that issue is not properly before this Court.

Scottsdale's alternative argument alleges that even if coverage would otherwise exist in this case, "Scottsdale legitimately denied coverage on the basis of Architex's failure to give timely notice" and thereby "prejudiced Scottsdale's ability to defend Architex." (Appellee Br., pp. 24-26). Although Scottsdale dedicates much of its Brief to the subject, the trial court intentionally and expressly made no ruling on this issue.[9] There has been no appeal from this issue, and it is not properly before the Mississippi Supreme Court.[10] If this Court agrees that the issue of notice is not properly before this Court, then the remaining portion of this section can be skipped. However, in the event that this Court is inclined to consider this argument regarding notice that the trial court declined to rule on, then Architex herein responds.

A. Architex's notice was timely and did not cause Scottsdale substantial prejudice.

In light of the fact that Scottsdale never once defended Architex and made no determination of coverage until two years after it received notice (Vol. 1, Ex. 12; RE 7), to say that Scottsdale's timeliness argument is audacious is a vast understatement. The notice provided by Architex is timely and, even if it were not, Scottsdale has not shown that it suffered any prejudice, much less "substantial prejudice" as required under Mississippi law.

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[9] More specifically, the Bench Opinion from which Architex has appealed states: "The Court has not addressed a number of issues and bases urged upon the Court, e.g. whether notice of claim was timely made. The Court believes that issue/basis and all other substantial issues are resolved by the Court's ruling herein." (R. at 3020; MRE 3). Other than by incorporation of the Bench Opinion, the Final Judgment is completely silent on the issue of notice. (R. at 3026-27; MRE 4).

[10] *See MS Comp Choice, SIF v. Clark, Scott & Streetman*, 981 So.2d 955, 963 (Miss. 2008)("Because the trial court did not rule on this issue, we will not address it."); *Williams v. Skelton*, 6 So.3d 428 (Miss. 2009)(approving Court of Appeals' holding that an alternative argument was not properly before the appellate court where "trial judge specifically declined to rule" on same); *see also Stubblefield v. Jesco, Inc.*, 464 So.2d 47 (Miss. 1984)(refusing on appeal to consider whether defendant was entitled to a new trial where it had filed a formal motion for a new trial but had not obtained from the trial judge a ruling on that motion.).

1. Architex provided Scottsdale timely notice of the claims.

Since Architex informed Scottsdale of the rebar claim ***six days*** after it first learned of the claim, Scottsdale's claim of untimely notice is baseless. Appellee's own expert testified that notice was not an issue in this case. Indeed, although Scottsdale flippantly characterizes Architex as being "misleading" throughout its brief (Appellee Br., p. 25, n. 8), it is difficult to see how this testimony was misinterpreted[11]:

> Q. Okay. Are you familiar with circumstances, or would you acknowledge that there are circumstances where a complaint can be filed and issues develop during the pendency of litigation that would give rise to a claim after?
>
> A. Oh. Yes. Yes.
>
> ...
>
> Q. Likewise, there are circumstances where the insured might not know that the plaintiff was claiming things that might be covered until later in the litigation, such as during discovery?
>
> A. Oh, there -- there are such -- yeah, there can be such circumstances, certainly.
>
> Q. And in -- and in those circumstances, it would be perfectly legitimate for the insured to give notice at that time?
>
> A. Oh, yes. Yeah. And, again, the notice issue is not troubling to me in this case.

(Vol. 4, Ex. 17 at 243, 245, 249; RE 18).

That view exposed by Scottsdale's expert is also fully supported by a record that shows it was ***impossible*** for Architex to provide any notice of the covered claims because the claims had not been made by the Owner. According to Scottsdale's logic, Architex was obligated to provide Scottsdale with notice of claims that did not exist, and were unknown to Architex and

[11] Architex's allegedly "misleading" statement was that "[Scottsdale's] own expert, Jeffrey Jackson, stated that he did not believe [notice] was an issue because Architex notified Scottsdale of covered claims as soon as possible, and that it is not uncommon for potentially covered claims to be discovered as litigation proceeds." (Appellant's Brief, p. 24) As can be seen *infra*, this description is both fair and accurate.

even unknown by the Owner making the claims against Architex. There is no dispute by Scottsdale that the Owner did not make any allegations of insufficient rebar until September 30, 2004. Architex did not have the ability, much less obligation, to provide notice to Scottsdale any sooner than it did in this matter. (Vol. 1, Ex. 6 at 18; RE 31).

Moreover, Owner's counsel provided Scottsdale with a PowerPoint presentation (Vol. 1, Ex. 4 at 53-55, 130-134 and 142; RE 42) that showed, among a multitude of other things, its claimed damages, including mold and mildew. (Vol. 22 at 21-22; RE 43). Additionally, in response to Scottsdale's letter denying coverage for the first time (Vol. 1, Ex. 12; RE 7), by letter dated September 18, 2006, Architex's counsel specifically included a description of the claims of water intrusion and mold and mildew. (R. at 1743-1749; RE 44). Nevertheless, in his deposition on July 7, 2007, some nine months later, Scottsdale's claims handler testified that he was never given this letter by counsel and, incredibly, *that he had no knowledge of these claims prior to his deposition*:

> Q. Okay. And you've never seen that letter before?
>
> A. *I don't recall ever seeing it.*
>
> Q. Let me -- let me direct you to the -- the bottom paragraph of the second page and ask you to read that, I know it's long. But if you will, read it out loud.
>
> . . .
>
> A. Okay. You want me to read it out loud. "In this case, although the plaintiffs have alleged, among other things, that Architex and/or its subcontractors negligently constructed the project and breached -- breached its contract with the plaintiffs for the construction of the project, the actual facts of this case go far beyond the allegations contained in the Complaint. Specifically, the plaintiffs claim that Architex and/or its subcontractors, was negligent in the construction of the project, and that as a result, damage was caused to other areas of the structure and to the work of others. In particular, the plaintiffs claim that because of the alleged negligence of Architex, leaks occurred that resulted in damages to the walls of several guest rooms and the hallways, mold has grown and become prevalent in several guest rooms and

> hallways; and hardware in the pool area has rusted. Numerous other problems have been alleged by the plaintiffs in their discovery responses, all of which are damages to parts of the project that were in good condition and workmanship, but allegedly as a result of Architex's or its subcontractor's negligence in other areas, are now damaged.
>
> Further, many of the alleged damages result from or arise out of the work of subcontractors on the project."
>
> . . .
>
> Q. Okay. Prior to today, you were not aware of those allegations being made in this lawsuit?
>
> THE WITNESS: (after objection) *That's the first time that I have learned of these items, which were not part of the lawsuit.*
>
> . . .
>
> Q. Would those allegations arguably come within coverage under the CGL policy?
>
> A: (after objection) *Arguably, you know, those allegations could possibly be construed as being covered under a CGL policy.*

(Vol. 1, Ex. 9 at 98-102; RE 12)(Italics added). Even after this testimony in 2007 wherein Scottsdale's claims handler says he first learned of leaks, mold, and rust that were previously "not part of the lawsuit," Scottsdale never investigated or defended these claims of which it received notice. Although these claims "could possibly be construed as being covered under a CGL policy," in Scottsdale's own words, Scottsdale continued to do absolutely nothing.

It is *impossible* for an insured such as Architex to notify its insurer of a claim before that claim exists. Scottsdale's argument that it was not provided adequate notice of Plaintiffs' allegations against Architex is not supported by any evidence in the record, is an impossibility, and should be summarily dismissed.

B. Scottsdale has not and cannot show "substantial prejudice".

Even if Scottsdale had not timely provided Scottsdale with notice of the claims, since the notice provision is a condition subsequent, Scottsdale has an affirmative duty to show substantial prejudice in order to deny Architex's coverage. *Capital City Ins. Co. v. Ringgold Timber Co.,*

Inc., 898 So.2d 680, 682 (Miss. Ct. App. 2004) (cert. denied) (citation omitted); *see also Commercial Union Ins. Co. v. Dairyland Ins. Co.*, 584 So.2d 405 (Miss. 1991). Further, and in addition, Scottsdale must show that the outcome in the action would have been radically altered had Architex complied with the notice provision. *Capital City*, 898 So.2d at 682 (citation omitted).

Scottsdale asserts two reasons that it has been "substantially prejudiced" by Architex's "late" notice of the claims asserted against it in the underlying matter. First, Scottsdale asserts that it lost the right to remove the instant action to federal court; and, second, Scottsdale alleges that it lost the right to arbitrate the underlying action.[12] (Appellee Br., p. 27).

Since the underlying action has been stayed and there has been no outcome, however, ***it is impossible*** for Scottsdale to meet its burden on the *Capital City* requirement "that the outcome in the liability action would have been radically altered." At any time, including now, Scottsdale could jump in and defend its insured, as specifically requested by Architex. There has been no outcome.

Moreover, even if we assume that somehow Scottsdale could magically prove that the outcome would be radically different in arbitration, Scottsdale fails to recognize that Architex notified Scottsdale of the insufficient rebar issues while this matter was still in arbitration and many months before the parties decided to waive the arbitration provision. In fact, the trial court did not resume jurisdiction over this matter until its Order dated July 19, 2005 (R. at 133-135; RE 45), ***over eight months*** after Scottsdale acknowledges receipt of the claim. It is simply offensive and egregious for Scottsdale to stand on the sidelines, refuse to defend its insured, and

[12] It is not clear whether Scottsdale is contending that it would have sought an outcome in federal court or in arbitration. It certainly would be unable to do both, as these two options would necessarily be mutually exclusive.

then argue that Scottsdale would not have been "handcuffed by all of the tactical decisions made by Architex's previous counsel" if it had selected counsel. (Appellee Br., p. 27).

V. Scottsdale's actions are a quintessential exhibition of bad faith.

In rendering its Final Judgment, the trial court agreed with Scottsdale "that since there is no coverage, and correspondingly no duty to defend, as a matter of law Scottsdale cannot be held liable for its alleged failure to act in good faith and fair dealing, failure to investigate, failure to abide by its own policies and procedures, and failure to abide by nationally-recognized industry standards." (R. at 3026-27; MRE 4). Simply stated, this finding is directly contrary to Mississippi law as set forth in *Bankers Life & Cas. Co. v. Crenshaw,* 483 So.2d 254 (Miss. 1985), *Andrew Jackson Life Ins. Co. v. Williams*, 566 So.2d 1172, 1188 (Miss. 1990), and their progeny.

A. Regardless of coverage, Mississippi law recognizes a separate duty to investigate, duty to defend, and duty to act in good faith and fair dealing.

As support for its "No Bad Faith" argument, Scottsdale relies upon *Stubbs v. Mississippi Farm Bureau Cas. Ins. Co.*, 825 So.2d 8 (Miss. 2002) for the proposition that a claimant must prevail on coverage before a question of bad faith may be submitted to the jury. (Appellee Br., p. 28). However, Scottsdale fails to note that *Stubbs* does not involve claims of bad faith based upon the insurer's failure to defend or its failure to investigate. Whether the insurer had properly investigated and defended a claim was not an issue. Rather, the *sole issue* was whether the insurer had acted in bad faith *in failing to provide coverage. Stubbs,* 825 So.2d at 13. More importantly, *Stubbs* is a first-party insurer case. There are major differences between first-party and third-party insurers. Third-party insurers owe ***fiduciary*** duties to their insureds because, as opposed to first-party insurers, the third-party insurer stands between its insured and "potentially ruinous personal liability." Jeffrey Jackson, MISSISSIPPI INSURANCE LAW AND PRACTICE, § 2:2 (2007).

In arguing that coverage is a prerequisite to a finding of bad faith, Scottsdale completely ignores the fact that, in addition to the failure to cover and indemnify, Scottsdale has breached at least three other separate duties recognized by Mississippi law as being owed by an insurer to its insured--the duty to investigate,[13] the duty to defend, and the duty to act in good faith and fair dealing.[14] Thus, Mississippi law recognizes that the question of an insurer's bad faith can go before a jury even where there is no coverage. Indeed, in this case, contractual remedies alone provide no disincentive for Scottsdale to repeat the outrageous conduct that it has displayed in this case.

B. Scottsdale acted in bad faith regardless of coverage.

Although Scottsdale failed to follow its own claims handling policies and procedures (Vol. 2, Ex. 15 at 345-351; RE 21), did not conduct any investigation other than obtaining a single statement (Vol. 1, Ex. 11 at 27, 32, 34-35, 41-43, 75-80; RE 11), did not and has not interviewed the claimant or the claimant's attorney (Vol. 1, Ex. 9 at 58-71; RE 28), did nothing for six entire months even though Scottsdale claims that it had never seen the complaint or spoken with its insured (Vol. 1, Ex. 9 at 58-71; RE 28), failed to assign this claim to its construction defect group (Vol. 2, Ex. 15 at 44, 50-51 and 54; RE 24), did not make a determination of defense or coverage until two years after receiving notice (and, even then, only after its insured filed suit) (Vol. 1, Ex. 9 at 87-89; RE 5), and even admits that the mold and mildew claims (the same claims that it refuses to investigate) (Vol. 1, Ex. 4 at 53-55, 130-134, 142; RE 42) are "arguably" and "potentially" covered here--thereby making the duty to defend its insured absolute, Scottsdale argues that Architex "has ***no*** evidence of bad faith." Although the

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[13] *See Bankers Life & Cas. Co. v. Crenshaw,* 483 So.2d 254, 276 (Miss. 1985) ("an insurance company has a duty to the insured to make a reasonably prompt investigation of all relevant facts.").

[14] *See Andrew Jackson Life Insurance Company v. Williams*, 566 So. 2d 1172, 1188 (Miss. 1990) ("every contract contains [an implied] covenant of good faith and fair dealing.").

trial court ultimately dismissed the bad faith claims due strictly to a finding of lack of coverage, even the trial court recognized proof of bad faith by Scottsdale:

> THE COURT: ... But it seems to me like -- *I get a distinct odor here that Scottsdale knows that this particular insured is broke, hanging on by a thread, and is going to make them jump through every conceivable hoop, and that doesn't strike me as anything other than further proof of Scottsdale's bad faith.*

(Vol. 22 at 96-97, 110; RE 46)(Italics added). Indeed, the distinct odor is potent. Despite Scottsdale's baseless arguments otherwise, had it defended its insured as it was contractually obligated to do, Architex would not be bankrupt. Scottsdale should not be permitted to summarily escape liability for its egregious refusal to investigate, defend, and cover its insured, and for its complete lack of good faith and fair dealing. Contractual remedies alone provide no disincentive for Scottsdale to repeat the outrageous conduct that it has displayed in this case.

CONCLUSION

For all of the reasons established hereinabove, this Court should reverse the trial court's award of summary judgment, and find that negligent subcontractor construction defects that cause property damage and/or bodily injury are recognized as "occurrences" under CGL policies in Mississippi. The Court should also hold that Scottsdale has a duty to defend Architex in the underlying matter and should indemnify and reimburse Architex for all of its attorney's fees and other costs associated in this matter, as well as any other relief this Court deems proper.

Respectfully submitted, this the 17th day of June, 2009.

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