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

BRIEF OF APPELLANT

ORAL ARGUMENT REQUESTED

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SCOTTSDALE INSURANCE COMPANY APPELLEE

CERTIFICATE OF INTERESTED PARTIES

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

1. Architex Association, Inc., third-party plaintiff and appellant
2. Dorsey R. Carson, Jr., and Cheri Turnage Gatlin, Burr & Forman LLP, Jackson, Mississippi, counsel for Architex Association, Inc.
3. Scottsdale Insurance Company, third-party defendant and appellee
4. James W. Shelson and Justin L. Matheny, Phelps Dunbar LLP, Jackson, Mississippi, counsel for Scottsdale Insurance Company.
5. Vikram Parshotham, plaintiff
6. CIS Pearl, Inc., plaintiff
7. Mark C. Baker, Baker Law Firm, and Joshua C. McCrory, McCrory Law Firm, Brandon, Mississippi, counsel for Vikram Parshotham and CIS Pearl, Inc.
8. Hanover Insurance Company, third-party defendant
9. Pre-Build Company, Inc., third-party defendant
10. Guy Barr d/b/a L&B Construction, Inc., third-party defendant
11. James Mathew d/b/a L&B Construction, Inc., third-party defendant
12. Leonard Coleman d/b/a Continental Construction, third-party defendant
13. Mike Rasmussen, third-party defendant

14. Schindler Elevator Corp., third-party defendant

15. M.D. Bailey & Sons Electrical Co., Inc., third-party defendant

16. Hughes Brothers Plumbing Company, Inc., third-party defendant

17. R&R Mechanical, Inc., third-party defendant

18. Central Asphalt Co., Inc., third-party defendant

19. Darryl Callendar d/b/a Callendar Enterprises, third-party defendant

DORSEY R. CARSON, JR.
CHERI T. GATLIN
Counsel of record for Architex Association, Inc.

STATEMENT REGARDING ORAL ARGUMENT

Oral argument is respectfully requested by Architex to ensure sufficient discussion of the applicable law and the public policy arguments related to this matter. Additionally, oral argument is requested in order to respond to any new contentions the appellee may make in its response brief. The resolution of the disputed issue will significantly impact the state's construction industry and economic development, and as such, Architex believes oral argument would be beneficial to the Court.

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STATEMENT OF THE ISSUES

The Rankin County Circuit Court held that a construction defect resulting from acts of a subcontractor cannot be an "accident or occurrence" that would trigger coverage under a CGL insurance policy. The questions of first impression before this Court are as follows:

1. Is an inadvertent construction defect arising out of a subcontractor's work that causes bodily injury or property damage considered an "accident or occurrence" under a contractor's Commercial General Liability ("CGL") insurance?

2. If so, does Scottsdale Insurance Company ("Scottsdale") have a duty to defend Architex and provide coverage in the action filed by Vikram Parshotham ("Parshotham") and CIS Pearl, Inc. ("CIS"), (collectively, the "Plaintiffs") according to the CGL policy issued to Architex by Scottsdale?

STATEMENT OF THE CASE

Architex Association, Inc. ("Architex") is a general contractor that was hired to complete the construction of the Country Inn and Suites in Pearl, Mississippi. Before beginning work on the project, Architex secured insurance from Scottsdale Insurance Company ("Scottsdale") under a Commercial General Liability ("CGL") policy on or about June 29, 1999. Scottsdale issued policy numbers CLS0527059 and CLS0728184 to Architex. These policies are modeled after the Insurance Services Office Broad Form Property Damage Endorsement No. CG 00 57 09 99. Architex has ceased its business operations due to the cost of the current litigation, but while in business as a general contractor, Architex paid Scottsdale premiums in exchange for protection under the CGL policy at issue in this case, including premiums specifically designated to cover the acts of subcontractors. (Vol. 1, Ex. 2 at unpaginated 12, 42 Commercial General Liability Coverage Part Extension of Supplemental Declarations; RE 1).

Vikram Parshotham ("Parshotham") and CIS Pearl, Inc. ("CIS") filed suit against Architex on July 31, 2002, for alleged breaches and negligence arising out of the construction of the Country Inn and Suites in Pearl, Mississippi. (R. at 45; RE 2). The complaint contained counts for breach of contract, negligence, claims on the performance bond, and slander of title. (R. at 45; RE 2). Years after filing suit, the plaintiffs further claimed that as a result of Architex's negligence, or that of one or more of Architex's subcontractors, damage has been caused to the property through lack of sufficient rebar in the foundation, water intrusion, mold and mildew intrusion, and rusting of fixtures and hardware. All parties acknowledge that Architex did not perform any work on the project and that all work was completed through subcontractors.[1]

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[1] The following is a list of subcontractors, sub-subcontractors, manufacturers and/or suppliers who performed work on the Project and/or supplied materials: (1) A-1 Roofing and Guttering Co.; (2) Ainsworth Pool Tech; (3) American HinTech; (4) Apex Supply; (5) Aqua-Lawn; (6) Ark-La-Tex

On or around October 5, 2004, Architex and prior counsel for Architex provided Scottsdale with notice of the September 30, 2004 claim that there was structural damage caused by lack of sufficient rebar. (Vol. 1, Ex. 5; RE 3). In response to the notice of claim, Scottsdale provided Architex with a "reservation of rights" letter on October 8, 2004. (Vol. 1, Ex. 7; RE 4). The language of Scottsdale's letter was unclear, as it did not deny or accept coverage or defense, nor did Scottsdale reserve its rights in a traditional sense by tendering coverage or defense to Architex while an investigation was pending. *Id.*

Prior counsel for Architex provided Scottsdale with a copy of the complaint. Architex's prior counsel testified that he sent one copy in 2004, and all parties agree that Scottsdale received a copy of the complaint by at least April 2005. (Vol. 1, Ex. 9 at 77, 84-85; RE 5). Having received no response from Scottsdale, Architex was granted leave to file a third-party complaint against Scottsdale seeking indemnity and payment of defense costs and expenses. (Vol. 2, Ex. 13; RE 6). On September 6, 2006, Scottsdale denied the claim without investigation into the allegations of the complaint, the plaintiff's new claim for mold and mildew, or the claim for lack of sufficient rebar. (Vol. 1, Ex. 12; RE 7). By letter to Scottsdale's counsel, Architex again notified Scottsdale of the prior claims on September 18, 2006, including the recently discovered mold and mildew claims alleged by CIS and Parshotham. (Vol. 1, Ex. 10; RE 8).

Wallsource, Inc.; (7) Bailey Electric; (8) Bemis; (9) Bend of the River; (10) Cajun Carpets; (11) Callender Enterprises; (12) Central Asphalt; (13) Chris-More, Inc.; (14) Concrete Creations; (15) Continental Construction; (16) Custom Millworks; (17) Daltile; (18) David Futrell; (19) Delta Faucet Co.; (20) Elizer; (21) Flag Source; (22) Griggs & Son Construction; (23) Helping Hand; (24) Hi-tower Gycrete; (25) Holley Construction; (26) Hughes Brothers Plumbing; (27) Ilco; (28) Imperial Contract Wallcoverings; (29) Ivy Waltman, Inc.; (30) Jackson Ready Mix; (31) John Matthews; (32) Kaba-Ilco; (33) KD Construction; (34) Konover Swinerton; (35) L&B Construction; (36) Lexmark Carpet Mills; (37) McKay Drywall; (38) Masterchem Inc.; (39) Mike Rasmussen; (40) Old South Brick & Supply; (41) Pre-build Co.; (42) Prem Supply; (43) Puckett Rents; (44) R&R Mechanical; (45) Roadrunner Lock Co.; (46) Roger Dooley; (47) Schindler Elevator; (48) Smart Landscapes; (49) Southeast Automatic Sprinkler; (50) Southeast Wholesale Door; (51) Tandem Staffings; (52) The Carpet Expert; (53) Thrasher Door & Hardware; (54) Valiant Products Corporation; (55) Waste Management; and (56) Wickes Lumber.

Charles Buchanan, Scottsdale's 30(b)(6) designee for specific areas of inquiry, testified in his July 9, 2007 deposition that after receiving notice of the claims against Architex, it hired Crawford & Company, an insurance investigation and appraisal service, to investigate the claims. Architex's prior counsel testified that he spoke with Chad Thrash, an investigator with Crawford. (Vol. 4, Ex. 4 at 14, 23, 33; RE 9). Crawford reported to Scottsdale in a letter dated November 23, 2004, and received on December 7, 2004. (Vol. 1. Ex. 9 at 53; RE 10). The letter acknowledged that Architex's counsel had already produced documents and was willing to produce any additional documentation related to the claims. (Vol. 4, Ex. 4 at 24-25; Vol. 4, Ex. 4B; RE 9). The letter then proceeded to close the investigation file as Crawford's only task was to obtain a statement from Vic Hamby, Architex's CFO and Vice-President, and Crawford did not complete that task because it was informed by Architex's prior counsel that he and Larry Bielski, Architex's project manager, had more information than Vic Hamby. (Vol. 1., Ex. 9 at 52-54; RE 10; Vol. 1, Ex. 11 at 27, 32, 34-35, 41-43, 71, 75-80; RE 11). During that same deposition, Charles Buchanan also admitted that Scottsdale was unaware of the mold and mildew claims because he had not seen the September 18, 2006 letter that had been sent to its attorneys. He then admitted that the presence of mold and mildew in the building provided an arguable basis for coverage under the CGL policy. (Vol. 1, Ex. 9 at 98-108; RE 12). Another 30(b)(6) representative for Scottsdale also admitted that in sixteen of twenty-five construction defect cases pending in Mississippi since 2000, Scottsdale has tendered a defense and costs for its insured, and in many cases, ultimately indemnified its insured.

Architex and Scottsdale filed cross motions for summary judgment in the Circuit Court of Rankin County. Architex sought summary judgment on Scottsdale's duty to defend and provide coverage in the action filed by CIS and Parshotham while Scottsdale filed separate summary judgment motions on all bad faith and non-bad faith claims. Circuit Court Judge Kent McDaniel

found that all of Architex's claims against Scottsdale in its third amended third-party complaint should be dismissed with prejudice, but also felt constrained and stated that "it may be time for the Courts of this state to expand that language and law so as to bring construction defects under the indemnity and defense obligations included in CGL policy language." The Court also held that the CGL policy provides no coverage for the claims alleged by Parshotham and CIS, and that Scottsdale's motions for summary judgment should be granted. Architex subsequently filed this timely appeal.

SUMMARY OF ARGUMENT

CGL carriers have, for decades, covered an owner's or contractor's damages caused by defective subcontractor work. Therefore, whether property damage caused by the faulty work of a subcontractor is considered an "accident or occurrence" under a contractor's CGL insurance policy is an issue of first impression before this Court. This Court should rule that a construction defect from negligent subcontractor work is an "occurrence" under CGL policies in Mississippi because a negligent construction defect is unintended and unexpected, and because the "Broad Form Property Damage" language of the post-1976 CGL policies contemplates coverage for defective subcontractor work. Scottsdale issued Architex a standard CGL contract drafted by the ISO, and brochures promulgated by the ISO state that the purpose of the language in the policies is to provide subcontractor coverage for faulty work. (R. at 2975 - 3001; RE 13). A narrow reading of the contract to suggest that the act of hiring a subcontractor constitutes an intentional act outside the realm of insurance coverage negates the purpose of a contractor purchasing this insurance and negates the purpose of an owner, developer, bank or other interested party requiring its purchase.

In the instant matter, Architex's position is that although it did intend to hire subcontractors to do the construction work on the Country Inn and Suites in Pearl, Mississippi, as fully disclosed in its written application, it certainly did not intend for those subcontractors to undertake any work in a manner that would cause construction defects. All contractors intend to hire workers; however, they do not intend for the subcontractors to perform defective work. To extrapolate intent back to the hiring process is not the correct analysis, as all acts are intentional on some level. The value of CGL insurance would be undermined if a contractor's act of engaging in the process of work -- the hiring of a subcontractor -- constitutes an intentional act disqualifying the contractor from coverage. The construction defects alleged in this case are

exactly the type of "occurrences" that are meant to trigger CGL coverage according to the 1976 and 1986 ISO document language that was in the CGL policy used by Scottsdale. Scottsdale contemplated its exposure for subcontractor liability when it charged and accepted premiums specifically designated for subcontractor work. Thus, Scottsdale has the duty to defend Architex as its insured.

Scottsdale has admitted that the mold and mildew claims present an arguable basis for coverage under the policy. An insurance company has a duty to defend its insured when an arguable basis for coverage exists. Not only has Scottsdale failed to defend despite knowledge that an arguable basis for coverage exists, Scottsdale has engaged in behavior indicative of bad faith. Scottsdale has also failed to investigate and to act in a manner evidencing good faith and fair dealing.

Scottsdale has admitted that it did not follow its own policies and procedures, nor did it adhere to national standards in its handling of Architex's claim. Scottsdale failed to assign Architex's claim to its construction defect group, as is its customary procedure. It only hired an investigator to get a statement from Vic Hamby, who was not the proper Architex representative. Scottsdale never inspected the property, nor did it confer with the claimant or the claimant's attorney. Scottsdale's two-year delay in issuing a letter denying coverage, also contrary to company policy, has led to Architex being forced out of business due to overwhelming litigation costs. Even then, Architex did not issue a letter denying defense and coverage until after Architex was forced to sue Scottsdale. Like Architex, other contractors will be either forced out of business, or forced to work outside of the state of Mississippi, if the Scottsdale interpretation of the CGL policy prevails. Additionally, the CGL insurance contract required of contractors by public and private owners, banks, and developers would be useless to cover bodily injury and property damage caused by subcontractor negligence.

ARGUMENT

I. A construction defect by a subcontractor constitutes an occurrence that triggers coverage under a Commercial General Liability insurance policy

The vast majority of insurance policies, including the policy at issue in this case, utilize language drafted by the Insurance Services Office ("ISO"), an insurance industry trade association. David Dekker, Douglas Green, & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28-FALL Construction Law. 19 (2008). An examination of the history of the Broad Form Property Damage ("BFPD") endorsement is instructive in determining the intent of insurers. Dekker, Green, and Palley outline the history as follows:

> Before 1973, standard-form CGL policies contained an exclusion that eliminated coverage for "property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof." The "on behalf of" language under this exclusion meant that no coverage existed for damage to the insured's own work resulting from a subcontractor's defective work. Thus, under this exclusion, general contractors bore the risk that subcontractors would expose the general contractor to enormous unforeseeable damages. This was problematic for contractors, as a subcontractor doing $10,000 in work could easily cause $10,000,000 of damages, which of course remains the case today--scope and cost are not necessarily a reliable predictor of long-term risk.
>
> In response to industry concern, insurance companies began offering coverage for the risk of damage to otherwise nondefective work resulting from defective subcontractor performance. This coverage became known as BFPD coverage.
>
> 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 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."
>
> Through the 1970s and early 1980s there continued to be confusion about the extent of coverage provided under the BFPD endorsement. Accordingly, in 1986 ISO made that coverage a part of its standard form basic insuring agreement for general liability policies, now the CG 00 01 policy form. Although the ISO forms have continued to evolve since 1986, the BFPD coverage language, which is discussed below, has remained the same.
>
> Post-1986 ISO CGL policies provide coverage in pertinent part for "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." The legal obligation

> to pay, however, must arise from an "occurrence," which is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful condition." Coverage for "damages because of 'property damage'" to the insured's own work is typically limited by exclusion l in the standard policy form, which excludes:
>
> "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard." This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a **subcontractor**. [Emphasis added.]
>
> The final clause of exclusion l is commonly referred to as the "subcontractor exception" to the "your work" exclusion. This clause provides the insured with the BFPD coverage described above by excepting from the exclusion liability arising out of the defective work of subcontractors.

David Dekker, Douglas Green, & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28-FALL Construction Law. 19, 19-20 (2008) (emphasis in original).

The 1979 ISO Explanatory Memorandum of Broad Form Property Damage Coverage explains exclusion (z) in the advisory endorsement ADV.-3006-Broad Form Property Damage Endorsement Including Completed Operations. In interpreting the language subsequently adopted into the CGL policies in 1986, the memorandum stated:

(z) - This exclusion in endorsement ADV.-3006, which modifies the corresponding policy exclusion, provides broad form completed operations property damage coverage by excluding only damages caused by the named insured to his own work. Thus,

1. The insured would have no coverage for damage to his work arising out of his own work.

2. The insured would have coverage for damage to his work arising out of a subcontractors work.

3. The insured would have coverage for damage to a subcontractor's work arising out of the subcontractors work.

4. The insured would have coverage for damage to a subcontractor's work, or if the insured is a subcontractor to a general contractor's work, or another subcontractor's work, arising out of the insured's work.

(R. at 2977) (emphasis in original).

Before beginning work on the Country Inn and Suites, Architex purchased a CGL insurance policy from Scottsdale. In interpreting an insurance policy, all relevant portions should be considered together, and when possible, operative effect should be given 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 (Miss. 1998). Mississippi law recognizes the general rule that provisions of an insurance contract are to be construed strongly against the drafters, and this Court interprets and construes insurance policies liberally in favor of the insured, especially when interpreting exceptions and limitations. *Id.* Section I of the policy provides in pertinent part:

> 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 the insurance applies . . . .
>
> 2. Exclusions
>
> l. Damage to Your Work
> "Property damage" to "your work" arising out of it or any part of it and included in the "products completed operations hazard."
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

The policy defines "property damage" under Section V, at Paragraph 17. "Property damage" is defined as:

> 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 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.

The "products completed operations hazard" is defined in Paragraph 16 as follows:

a. Includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except:

(1) Products that are still in your physical possession; or

(2) Work that has not yet been completed or abandoned. However, "your work" will be deemed completed at the earliest of the following times:
   (a) When all of the work called for in your contract has been completed.
   (b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site.
   (c) When all of the work done at a job site has been put into its intended use by any person or organization other than another contractor or subcontractor working on the same project.

   Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.

(Vol. 1, Ex. 2; RE 1).

An "occurrence" is defined by the policy as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." See Vol. 1, Ex. 2 at Section V, ¶13; RE 1. Mississippi law defines an accident as something that produces unexpected and unintended results. *Rogers v. Allstate Ins. Co.*, 938 So.2d 871, 875 (Miss. Ct. App. 2006); see also *Harrison v. Ohio Casualty Ins. Co.*, 199 F. Supp. 2d 518, 521 (5th Cir. 2002)(holding that the focus of "occurrence" or "accident" is that the event giving rise to the claim should be neither expected or intended from the standpoint of the insured). In the instant matter, the plaintiffs' allegations against Architex include claims of insufficient rebar in the foundation causing structural damage, insufficient water barriers leading to leaks in the walls of the facility, rusted metal in the hotel pool, and the resulting mold and mildew claims. These allegations, if proven true, are all unexpected and unintended from Architex's [the insured's] standpoint and therefore constitute an occurrence according to the terms of the contract.

At the lower court, Scottsdale characterized the plaintiffs' allegations as claims for property damage due to defective workmanship to suggest that no "occurrence" had transpired

under the subject policy. Scottsdale, as well as the lower court, relied on the Fifth Circuit's *Erie*-guess in *ACS Construction Co., Inc., of MS v. CGU*, 332 F.3d 885 (5th Cir. 2003) and the Misissippi Supreme Court decision in *United States Fidelity & Guaranty Company v. Omnibank*, 812 So.2d 196 (Miss. 2002). Reliance on *ACS* and *Omnibank* is misplaced. *ACS* held that the faulty workmanship of a waterproofing membrane resulting in the leaks did not constitute an "occurrence" under the policy. As this Court is aware, federal court decisions are not binding precedent on state courts. See *Boteler v. State Farm Cas. Ins. Co.*, 876 So.2d 1067, 1070 (Miss. App. Ct. 2004) (finding that a federal court interpretation of Mississippi law is simply persuasive and is not binding on the state courts.); see also *Essex Ins. Co. v. Massey Land & Timber*, 2006 WL 1454767 at *3 (S.D. Miss. 2006) (holding that when making an *Erie* guess in the absence of explicit guidance from the state courts, federal courts must attempt to predict state law not to create or modify it.). Further, the facts of *ACS* are not analogous to the instant factual secnario and its analysis relied on cases that did not address insurance coverage on a completed construction project which triggers the completed operations hazard portion of the policy. ACS, unlike this case, involved defective subcontractor work discovered by the general contractor during construction.

In *ACS*, the facts of the case included a claim that work had been performed deficiently, but the property damage for which the insurer sought a defense and indemnity was the allegedly defective work itself -- not damage to other property. Moreover, the project was still under construction so the damage was not included in the "products completed operations hazard." ACS contracted with the U.S. Army Corps of Engineers to construct munition bunkers at a base in North Carolina. 332 F.3d at 887. ACS subcontracted the job of installing a waterproof membrane to the roofs of the bunkers. *Id.* The installation of the waterproof membrane took place and subsequently, leaks developed. *Id.* After unsuccessful attempts by ACS to get the

subcontractor to correct the leaks, ACS, who remained responsible for the project, was forced to make the repairs during construction. ACS suffered a loss in excess of $190,000 for having to rework the waterproofing. *Id.* ACS sought recovery for replacement of the water-proofing itself, not for damage to other property as alleged by Parshotham here. Under these facts, where the insured was seeking indemnity for damages associated with its own faulty workmanship, the court found no "occurrence." *Id.* at 892.

In the case at hand, the damage alleged goes beyond the location of the defective work and includes damage to other property. Further, there was no third-party claim by an owner because the project was not completed. Since the project in *ACS* was not complete, the performance bond was still operable and, in regards to the general liability policy, the "products-completed operations hazard" coverage of the liability policy did not apply. Here, in contrast, the damage to the hotel is alleged to have occurred well after the building was occupied and used. Scottsdale acknowledges that the claims were not made until after the hotel received its certificate of occupancy. (Vol. 2, Ex. 15 at 171-72; RE 16). This case does not operate under an *ACS* factual scenario and is not controlled by the rationale or holding of ACS.

In *ACS*, the parties proferred different definitions of the term "accident," based on guidance from Mississippi case law. None of the case law analyzed in *ACS* addressed CGL coverage in construction. The insurance company proferred the definition as outlined in *Allstate Ins. Co. v. Moulton,* 464 So.2d 507 (Miss. 1985), a malicious prosecution case in which the Mississippi Supreme Court held that the test for determining an accident is whether the insured intended the *underlying* action. *Id.* at 888. (emphasis in original). ACS contended that the definition that should be utilized was outlined in *Southern Farm Bureau Casualty Ins. Co. v. Allard*, 611 So.2d 966 (Miss. 1992), a case involving coverage for a shooting under a homeowner's general liability policy. In that case, the Mississippi Supreme Court stated that the

test was whether the insured intended the *consequences* of his actions. *Id.* (emphasis in original). The *ACS* court looked to *U.S.F.&G. Co. v. Omnibank*, 812 So.2d 196 (Miss. 1996), a case that addressed the tension between the holdings in *Moulton* and *Allard.* The *ACS* court found that *Omnibank* reaffirmed the definition of "accident" in *Moulton.*

The question certified to the Mississippi Supreme Court in *Omnibank* was "whether, under Mississippi law, an insurer's duty to defend under a CGL policy for injuries caused by accidents extends to injuries unintended by the insured but which resulted from intentional actions of the insured if those actions were negligent but not intentionally tortious." 812 So. 2d at 197. Specifically, the case involved whether a bank's commercial general liability policy covered it for potential liability to its borrower for "force-placing" insurance on collateralized loans causing economic loss to the plaintiffs, and whether the bank's intentional act of purchasing "force-placed" insurance for borrowers was an accident. Quite correctly, the Mississippi Supreme Court held that this was an intentional act excluded as a result of the intentional acts exclusion of the policy. In so holding, the Court stated that "the exclusion in both policies mandates that coverage does not apply to 'bodily injury' or 'property damage,' expected or intended from the standpoint of the insured. An accident, by its very nature, produces unexpected and unintended results. It follows that bodily injury or property damage, expected or intended from the standpoint of the insured, cannot be the result of an accident." *Id.* at 199-200. The *Omnibank* Court did not hold, however, that there is never an accident or occurrence if the insured is engaged in the business or venture for which it sought insurance. Such a broad reading is contrary to the purpose of insurance. By its very nature and definition, a CGL policy is purchased for the purpose of covering the insured's business venture: in this case, construction. The trial court's holding that Architex's act of hiring subcontractors to complete work is an intentional act not covered by the CGL policy completely negates any incentive for a

contractor to purchase insurance. It also negates the purpose behind Mississippi statutes, rules and regulations requiring contractors to maintain CGL policies on public construction projects, and it shifts all risk from the insurer to the contractor and owner. While Architex acknowledges and respects the holding in *Omnibank*, both *Omnibank* and *ACS* reaffirm the holding in *Moulton* --- a non-construction case decided in 1985. Both of these cases fail to address the 1986 addition of the subcontractor exception to the "your work" exclusion, an issue relevant only in the context of construction.

A. Construction defects caused by the work of subcontractors are covered under this CGL policy, as is work performed directly by the insured if damage is to other property

The your-work exclusions and the subcontractor exception to that exclusion, the ongoing operations exclusion, and recognized exclusions for mold and subsidence which were not included in this policy, are all relevant to the analysis because they were developed by the industry to ensure that certain events beyond the control of the insured-contractor are covered. The subcontractor exception to the your-work exclusion demonstrates the intent of the contracting parties that property damage caused by the work of a subcontractor is intended to be a covered occurrence under the policy. The products-completed operations provision demonstrates that defects in the work after the construction is completed are likewise occurrences.

While Mississippi has never directly addressed what constitutes an accident or occurrence to trigger policy coverage in construction cases, several jurisdictions have addressed this matter in depth. A vast majority of jusidictions find coverage for subcontractor work. David Dekker, Douglas Green, & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28-FALL Construction Law. 19, 23 (2008).

The Texas Supreme Court provided an in-depth analysis of the history of CGL policies in a construction context in *Lamar Homes v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007).

In *Lamar Homes*, an insured builder sought a declaratory judgment that its CGL insurer owed a duty to defend and indemnify its insured in a homeowner's suit alleging construction defects. *Id.* at 5. The plaintiffs purchased a new home from Lamar Homes and several years later encountered problems they attributed to defects in their foundation. *Id.* The plaintiffs sued Lamar and its subcontractors for those defects. *Id.* Lamar forwarded the complaint to Mid-Continent seeking a defense and indemnification under a CGL policy. *Id.* Mid-Continent refused to defend, prompting Lamar to seek a declaration of its rights under the CGL policy. *Id.* The federal district court granted summary judgment for Mid-Continent, concluding that it had no duty to defend Lamar for construction errors that harmed only Lamar's own product. *Id.* On appeal, and noting there was disagreement among Texas courts, the Fifth Circuit certified questions to the Texas Supreme Court for resolution. *Id.*

The pertinent certified question presented to the Texas Supreme Court was "when a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege an 'accident' or 'occurrence' or 'property damage' sufficient to trigger the duty to defend or indemnify under a CGL policy." *Id.* at 7. In finding that construction defects that injured a general contractor's own work constituted an occurrence triggering coverage under a CGL policy, the Texas Supreme Court noted that a deliberate act, performed negligently, is an accident if the effect is not an intended or expected result; that is, the result would have been different had the deliberate act been performed correctly. *Id.* at 8 (citing *Mass Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396, 400 (Tex. 1967)). Thus, a claim does not involve an accident or occurrence when either direct allegations purport that the insured intended the injury (which is presumed in cases of intentional tort) or circumstances confirm that the resulting damage was the natural and expected result of the insured's actions, meaning the outcome was highly probable whether the insured was

negligent or not. *Id.* at 9. In the instant matter, none of the claims alleged against Architex are intentional torts. The alleged claims of insufficient rebar, water intrusion, and mold and mildew are all unintended and unexpected results of alleged subcontractor negligence. Architex did not subcontract with any party to place water, mold, and rust on the property of Parshotham. It could not and did not foresee the negligent construction by the subcontractors nor the extrinsic forces that led to the consequential damages stemming from mold and mildew in the constructed building, leaks from the walls of the facility, and rusted metal in the hotel pool. From the allegations and facts known, or which should be known by Scottsdale, an occurrence has transpired under the subject policy.

The *Lamar* court also addressed the subcontractor exception in the contract and acknowledged that the standard-form CGL has not always provided coverage for this business risk. *Id.* at 12 At one time, CGL policies routinely excluded property damage to the homebuilder's work without regard to its cause. *Id.* In 1976, however, insurers began offering an endorsement, known as the Broad Form Property Damage ("BFPD") endorsement, that extended coverage for damage to the builder's work if it were caused by a subcontractor. *Id.*; (R. at 2975; RE 13); *see also Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648, 651-654 (9th Cir. 1988) (explaining the rationale for the development of the BFPD endorsement). The Texas Supreme Court continued its analysis with discussion of the ISO's 1986 incorporation of the broad-form endorsement directly into the standard CGL policy by inserting the subcontractor exception into the "Your Work" exclusion. *Id.*; *see also Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65, 82 (Wis. 2004). By incorporating the subcontractor exception into the "Your Work" exclusion, the insurance industry contemplated coverage caused by a subcontractor's defective performance. *Id.*; see also *Limbach Co. v. Zurich Am. Ins. Co.*, 396 F.3d 358, 362-63 (4th Cir. 2005) (discussing history of the addition of the "subcontractor"

exception to the "your-work" exclusion); *Kalchthaler v. Keller Const. Co.*, 591 N.W.2d 169, 173-74 (Wis. App. 1999) (reviewing insurance industry publications stating that the subcontractor exception results in coverage if the work out of which the damage arose was performed by the insured's subcontractor).

Another decision illustrative of the case at bar is *United States Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007). In *J.S.U.B.*, the central issue concerned whether a post-1986 standard form CGL policy with a products-completed operations hazard clause provides coverage when a claim is made against the contractor for damage to the completed project caused by subcontractors' defective work. *Id.* at 874-875. J.S.U.B. contracted to build several homes, and upon completion and delivery, damage to the foundations, drywall, and other interior portions of the home appeared. *Id.* at 875. It was undisputed that the damage to the homes resulted from the subcontractors' use of poor soil and improper soil compaction and testing. *Id.* During this time, J.S.U.B. was insured under a CGL policy issued by U.S. Fire. The J.S.U.B. policy issued by U.S. Fire contains identical language and exclusions pertinent to the instant matter.

Like the Texas Supreme Court, the Florida Supreme Court engaged in analysis of the origin and evolution of CGL policies. The court quoted *Stempel on Insurance Contracts*, in its discussion of the reason for the 1986 revision that added the subcontractor exception:

> [T]he insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder itself. This resulted both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of insurers that the CGL was a more attractive product that could be better sold if it contained this coverage.
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> *Id.* at 879 (quoting 2 Jeffrey W. Stempel, *Stempel on Insurance Contracts* § 14.13[D] at 14-224.8 (3d ed. Supp.2007)).

The *J.S.U.B.* court expressly rejected the insurer's position that a subcontractor's faulty workmanship that damages the contractor's own work can never be an "accident" because it results in reasonably foreseeable damages *Id.* at 883. The court also rejected the position that defective work resulting in a claim against the contractor because of an injury to a third party is "unforeseeable," while the same defective work resulting in a claim against the contractor because of the damage to the completed project is "foreseeable." *Id.* It found that this distinction would make the definition of an "occurrence" dependent on which property was damaged. *Id.* After looking to similar decisions made by the Tennessee Supreme Court in *Travelers Indem. Co. of Am. v. Moore & Assoc., Inc.*, 216 S.W.3d 302 (Tenn. 2007), the Wisconsin Supreme Court in *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), and the Kansas Supreme Court in *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486 (Kan. 2006), the *J.S.U.B.* court concluded that defective work that causes damage to the contractor's completed project and is neither expected or intended from the standpoint of the contractor constitutes "an accident," and thus an "occurrence" as those terms are defined in a post-1986 CGL policy. *Id.* at 883-88.

B. A narrow interpretation of what constitutes an "occurrence" harms both the construction industry and the insurance industry in Mississippi

Architex paid premiums for liability coverage for subcontractor work in connection with construction of buildings. In the 1999 policy, Architex paid a premium of $6,580.00. $3,705.00 of the premium was specifically designated to be supplemental subcontractor liability coverage. (Vol. 1, Ex. 2 at 42 (unpaginated); RE 1). In the 2001 policy, Architex paid a premium of $8,008.00. Of that amount, $4,233.00 was specified for the supplemental subcontractor liability coverage. (Vol. 1, Ex. 2 at 12 (unpaginated); RE 1). A logical interpretation of this business transaction leads to the conclusion that both Scottsdale and Architex contemplated and understood that damage caused by its subcontractors would be covered under the policy.

Unquestionably, the ISO has promulgated a subcontractor exclusion that negates the subcontractor exception to the your work exclusion. *J.S.U.B.*, 979 So.2d at 884. Scottsdale could have chosen not to offer the subcontractor supplemental liability coverage to Architex. (Vol. 2, Ex. 17 at 160 (Scottsdale's expert Jeffrey Jackson admitting that there is an exclusion for subcontractor work and that it was not part of the policy in question); RE 14). Indeed, if Architex had not paid for the supplemental subcontractor liability coverage, then Scottsdale would have most assuredly included the subcontractor exclusion in Architex's policy.

As explained by Charles Roberts, Vice President of the Underwriting Division of Southern Insurance Underwriters, Inc. ("SIU"), under the supplemental subcontractor declaration, coverage is extended to Architex for subcontractor work in connection with construction. (Vol. 3, Ex. 3; RE 15). Mr. Roberts worked for SIU in the same capacity in the years applicable to the current coverage dispute between Architex and Scottsdale, specifically from 1998 through 2001. *Id.* SIU was the agent and underwriter for Scottsdale's Commercial General Liability ("GCL") Policy issued in 1998, and renewed annually through 2001. *Id.*

In 2001, Scottsdale provided its underwriters, including SIU, with guidelines and formulas for reference in issuing CGL policies. An example of these guidelines is Scottsdale's Revised Form 12-01(e) attached as Exhibit "B" to Vic Hamby's Affidavit. (Vol. 3, Ex. 3; RE 15). Revised Form 12-01(e) is a Scottsdale document, entitled *General Contactors Program,*[2] which evidences Scottsdale's pursuit of general contractors as insureds. The "Intent and Eligibility" section reads "[g]eneral [c]ontractors who have administrative or managerial responsibility for construction projects and exercise supervisory control of operations, whether direct or indirect, performed by employees and insured subcontractors in a variety of trades. Examples include:

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[2] This Court should be aware that this Scottsdale document, which is highly relevant and discoverable in this matter, was not produced by Scottsdale. The document was produced by SIU.

Commercial General Contractors." *Id.* Scottsdale considered Architex a Commercial General Contractor during the applicable period of insurance.

Revised Form 12-01(e) specifically provides guidelines for issuing a general contractor insurance for a subcontractors' work on a project. (Vol. 3, Ex. 3; RE 15). In 2001, Scottsdale's policy-issuance classification codes for "Subcontractors Work" were 91583 (residential) and 91585 (commercial). *Id.* At all times applicable to the underwriting of Architex's 2001 CGL policy issued by Scottsdale, Scottsdale determined a general contractor's premiums for policies issued for subcontract work based on a rating scale of the subcontract work. The rating was applied per $1,000 of the cost of subcontracted labor, and the cost included all materials furnished by the subcontractor. The rate was usually around $6.90/$1,000 cost at a $1,000,000 limit. *Id.* As stated by Scottsdale's underwriting agent, Charles Buchanan of SIU, Scottsdale's rationale behind collecting premiums was to ensure that Scottsdale collected adequate premiums to provide coverage for the general contractor's defense should the general contractor be named in a lawsuit involving a covered loss resulting from the actions of an uninsured or under-insured subcontractor.

Scottsdale's underwriting file shows that Scottsdale knew that Architex relied exclusively upon subcontractors to perform all of the construction work on the Project, and that Architex had paid premiums for subcontractor coverage. On the Contractors/Developers General Liability Application, which was filled out by Architex and submitted to the underwriter, SIU, Architex was required to list the subcontractor trades used and list a percentage of the work each subcontractor would perform. (Vol. 3, Ex. 6; RE 17). Architex's percentage of subcontractor work totaled 100 percent. *Id.* Likewise, Architex also provided that none of its employees perform any of the construction work. *Id.* Moreover, Architex noted that it was licensed and performing work in Mississippi, Arkansas, and Georgia. *Id.*

Having accepted Architex's premium payments for subcontractor coverage for years, Scottsdale now attempts to deny Architex the benefit of its bargain by claiming that defective subcontractor work is intentional, and contending that a subcontractor's work becomes the general contractor's work, i.e. "your work," which is excluded under the contract. This interpretation is contrary to the express language of the contract, which clearly recognizes subcontractor work as separate and apart from general contractor work.

If the Scottsdale interpretation of the contract becomes the law in Mississippi, both the construction industry, the insurance industry and the banking industry in Mississippi will suffer. As noted by several scholars on the history of the CGL policy, the 1986 subcontractor exception to the "your work" exclusion was added because the CGL policy was a more attractive product to contractors if this language was included. See *Stempel on Insurance Contracts* § 14.13[D] at 14-224.8 (3d ed. Supp.2007); David Dekker, Douglas Green, & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28-FALL Construction Law. 19, 19-20 (2008). Contractors will have less incentive to purchase standard CGL insurance contracts, as almost all commercial contractors subcontract their work. Insurance companies will see a decrease in policies sold because the contractors will not pay premiums for policies that no longer protect them. Further, the risk of construction will be too great for many contractors, owners, developers, and banks. It will also be too great for many subcontractors who purchase CGL policies to cover unintended bodily injury and property damage caused by their sub-subcontractors. A natural result of Scottsdale's position on subcontractor work is exorbatantly high construction costs in Mississippi, and eventually, a severe downturn of construction in Mississippi. Jeffery Stempel explains:

> Although it may be unwise to provide liability coverage for a builder directing its own crews, who may be tempted to cut corners if insured, the same rationale did not as readily apply to modern construction that depends heavily on subcontractors on whom general contractors depend. ... Particularly if the

> subcontractor does soil, concrete, or framing work, it is as a practical matter very difficult for the general contractor to control the quality of the subcontractor work. Only if the contractor has a supervisor at the elbow of each subcontractor at all times can quality control be relatively assured--but this would be prohibitively expensive. Because the general contractor depends on the subcontractor to a large degree, the general contractor is not tempted by moral hazard to the degree that makes the consequences of faulty subcontractor work more expensive to insure.
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> 2 Jeffrey W. Stempel, *Stempel on Insurance Contracts* § 14.13[D], at 14-224.8 (3d ed. Supp. 2007)

II. Scottsdale has a duty to defend Architex because the allegations constitute an occurrence under the CGL policy

Under Mississippi law, whether a liability insurance company has a duty to defend hinges on the language of the policy. *Rogers v. Allstate Ins. Co.*, 938 So.2d 871, 874 (Miss. Ct. App. 2006) (citing *United States Fid. & Guar. Co. v. Omnibank*, 812 So.2d 196, 200 (Miss. 2002)). The test for determining whether the insurer has an obligation to defend is accomplished by examining the allegations in the complaint or the declaration in the underlying action. *Id.* at 875. An insurer also has a duty to defend where the complaint fails to state a cause of action covered by the policy, but the insured informs the insurer that the true facts are inconsistent with the complaint, or the insured learns from independent investigation that the true facts present potential liability for the insured. *Farmland Mutual Ins. Co. v. Scruggs*, 886 So.2d 714, ¶19, n.2 (Miss. 2004) (citing *Mavar Shrimp & Oyster Co. v. U.S. Fidelity & Guaranty Co.*, 187 So.2d 871, 875 (Miss. 1966)). The duty to defend is broader than the insurer's duty to indemnify under its policy of insurance: the insurer has a duty to defend when there is any basis for potential liability under the policy. *Rogers* at 875. (quoting *Merchants Co. v. American Motorists Ins. Co.*, 794 F.Supp. 611, 617 (S.D. Miss. 1992)). The ultimate outcome or merit of the claim is irrelevant with regard to the question of a duty to defend. *Delta & Pine Land Co. v. Nationwide Agribusiness Ins. Co.*, 530 F.3d. 395, 399 (5th Cir. 2008).

Beyond the fact that the insurance contract provides coverage for subcontractor work under the terms of the policy, one of Scottsdale's 30(b)(6) representatives, Charles Buchanan, has admitted during a deposition that the mold and mildew claims present an arguable basis for coverage under the policy. (Vol. 1, Ex. 9 at 98-108; RE 12). Mr. Buchanan also stated that when there is an arguable basis for coverage, Scottdale's policy is either to defend under a reservation of rights or simply defend the lawsuit. *Id.* at 103. Scottsdale has done neither. Accordingly, Scottsdale has failed to meet its obligation to Architex, as the duty to defend has been triggered under Mississippi law.

Architex provided Scottsdale notice of the claims against it, including the new lack of rebar claims, in October 2004, and of newly discovered mold and mildew claims in September 2006. At the trial court level, Scottsdale half-heartedly asserted that it had been prejudiced because Architex failed to timely notify it of the claim, although its own expert, Jeffrey Jackson, stated that he did not believe it 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. (Vol. 1, Ex. 17 at 240-249; RE 18). The facts do not support Scottsdale's assertion. The trial court did not address the notice claim and it was not a basis for the court's grant of summary judgment.

Scottsdale chose to take no action for two years despite being put on notice of the claims against Architex. After initially being put on notice of the claims in September 2004, Scottsdale hired an investigator whose sole task was to take a statement from Vic Hamby, who was not at the project site and whose involvement was only as an owner. In its November 4, 2004 letter to Scottsdale, Architex's counsel expressly stated, "I will be happy to furnish such information as you need in order to make the decision that Scottsdale might provide a defense on the issue. If you need, as I suspect you might, to ask for additional information, please give me a call and I'll

respond as quickly as reasonably possible." (Vol. 4, Ex. 4A; RE 19) Despite Architex's willingness to provide more documentation to enable Scottsdale to investigate the claims, Scottsdale took no further action until counsel for Architex contacted it again in June 2006. (Vol. 1, Ex. 9 at 41-43, 75-80, 85-87; RE 20). In fact, the record is clear that Scottsdale did not adhere to its own policies and procedures regarding claim handling. (Vol. 2, Ex. 15 at 345-51; RE 21). Scottsdale's actions surrounding its failure to defend are indicative of bad faith.

Scottsdale freely admits that in sixteen of twenty-five construction defect cases pending in Mississippi since 2000, Scottsdale has tendered a defense and costs for its insured in construction defect claims, and in many of these cases, ultimately indemnified its insured. (Vol. 2, Ex. 15 at 210-309; 402-405; RE 22). Scottsdale has also admitted that it has failed to comply with its own policies and procedures, which in itself is a well-recognized basis for bad faith. *See Lewis v. Equity Nat. Life Ins. Co.*, 637 So.2d 183 (Miss. 1994). For example, Scottsdale's own policies and procedures for claims handling required Scottsdale to notify Architex within 30 days of its position as to defense and coverage. (Vol. 2, Ex. 15 at 363-65; RE 23). Scottsdale's letter to Architex dated October 8, 2004 undisputedly did not deny or affirm coverage or defense. (Vol. 1, Ex. 9 at 46-48; RE 20; Vol. 2, Ex. 15 at 323-26; RE 24). Scottsdale admits that it did not send a letter to Architex denying coverage and defense until September 16, 2006; two years after being notified of the lawsuit, and then only after Architex had filed suit against Scottsdale. (Vol. 1, Ex. 9 at 87-89; RE 20; Vol. 2, Ex. 15 at 370; RE 23). Clearly, Scottsdale failed to notify Architex of its defense and coverage position within 30 days, as required by the Scottsdale claims handling procedures manual. Of course, there were many other instances where Scottsdale concedes that it failed to follow its own policies and procedures for claims investigation. (*See, e.g.,* Vol. 2, Ex. 15 at 345-349; RE 21).

As another example, Scottsdale has a separate construction defect department that handles construction defect claims under this ISO standard form CGL policy. Scottsdale could not explain why this construction defect claim was not assigned to that department. (Vol. 2, Ex . 15 at 44, 50, 51, and 54; RE 24). Scottsdale's newfound argument that construction defects are ***never*** covered because they do not constitute an "occurrence" under the policy is contrary to Scottsdale's own interpretation of its policy in other construction defect cases both nationally and in Mississippi, is unsupported by any Mississippi case law, and runs directly contrary to the custom and usage of these policies in the construction industry in Mississippi. (Vol. 2, Ex. 16 at 11-16, 18-30; RE 25) (construction CGL policies have long been interpreted to cover damages caused by construction defects of subcontractors).

Scottsdale admits that it denied Architex's claim without any investigation into the mold and mildew claims, which Scottsdale admits were potentially covered. (Vol. 1, Ex. 9 at 98-108; RE 12). Scottsdale also admits that it failed to comply with national industry standards, which further evidences Scottsdale's bad faith and is a basis for liability. Specifically, Scottsdale admits to the following being nationally recognized standards in claims handling:

1) An insurance company is supposed to treat its insureds' interest at least equal to its own. (Vol. 2, Ex. 15 at 85; RE 26).

2) An insurance company cannot deny a claim or refuse payment of a claim without conducting a full and fair investigation of the facts and circumstances. *Id.*

3) An insurance company should investigate a claim with reasonable promptness and reasonable thoroughness. (*Id.* at 85-86, 90; RE 26).

4) An insurance company has to fairly and objectively evaluate a claim and not just focus on facts that would support denying a claim. (*Id.* at 86; RE 26).

5) An insurance company should pay claims unless there is a good reason not to supported by facts and information gathered by the company. *Id.*

6) An insurance company has a duty to assist an insured with its claim. *Id.*

7) An insurance company should not consider profit or loss when evaluating a claim. (*Id.* at 91; RE 26).

8) An insurance company should keep all significant matters that affect the interest of the insured in the handling of a particular claim in a claims file. (*Id.* at 99; RE 26).

All these principles were admitted as general, nationwide standard practices employed by reputable insurers. However, as shown by the material facts designated by Architex, Scottsdale has failed in every respect to handle Architex's claim in the manner in which it admits is the standard of the industry. Scottsdale's complete failure to do so only strengthens Architex's bad faith claims and furthers the need to place these issues of fact before the jury.

At the trial court, Scottsdale claimed that since there was no coverage for the claims asserted against Architex, there was no breach of any duty owed by Scottdale and therefore no bad faith. (R. at 2497; RE 27). While an insured must demonstrate that a duty was breached, Scottsdale completely ignores the fact that in addition to the failure to cover and indemnify, Architex has properly alleged that Scottsdale has breached at least three other separate duties owed by an insurer to its insured--the duty to investigate, the duty to defend, and the duty to act in good faith and fair dealing. "[E]very contract contains a[n implied] covenant of good faith and fair dealing." *Andrew Jackson Life Insurance Company v. Williams*, 566 So. 2d 1172, 1188

(Miss. 1990). This covenant applies to both insured and insurer --- albeit more so to the latter party. In short, the duty requires abstinence by *all* parties from commission of wrongful conduct which injures "the right of [the another] to receive the benefits of the agreement." *Id.* at 1188-89 (citing Shipstead & Thomas, *Comparative and Reverse Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing as Affirmative Defense or Counterclaim,* XXIII TORT & INS.L.J. 215, 218 (1987)."

Here, Scottsdale had a duty to conduct a reasonable investigation, and it failed to do one. Scottsdale had a duty to conduct a prompt investigation, and it failed to do one. In fact, Scottsdale did no independent investigation. Rather, it relied solely on its hired investigator, but that investigator was only assigned one task--to get a statement from Mr. Vic Hamby, who was not even the proper representative for Architex. Scottsdale did not inspect the building, or contact the hotel owner or the owner's attorney. It conducted no investigation of the mold and mildew claims at all, much less a reasonable and prompt one.

Moreover, at the very least Scottsdale owed a duty to defend until Scottsdale concluded its investigation and determined that there was no coverage. Although it had not denied coverage for a two-year period until Architex was compelled to file suit, Scottsdale failed to defend during that entire period, even under a reservation of rights. By the time a denial was issued, Architex had already expended over a hundred thousand dollars defending the lawsuit, which directly led to Architex's financial ruin. Here, in addition to a duty arising based upon Scottsdale's duty to cover, Scottsdale breached these other contractual obligations--its duty to investigate, to defend, and to act in good faith and fair dealing--and it did so in a manner indicative of bad faith.

At the lower court, Scottsdale relied on *Stubbs v. Miss. Farm Bureau Cas. Ins. Co.*, 825 So. 2d 8, 13 (Miss. 2002) and *Sobley v. Southern Natural Gas Co.*, 210 F.3d 561, 564 (5th Cir.

2000). These cases, unlike the lightning rod set of facts Architex has placed before this Court, fail to live up to the dichotomy cited by *Andrew Jackson Life Ins. Co. v. Williams*, 566 So.2d 1172, 1189 (Miss. 1990):[3]

> [O]ne of the benefits that flow [sic] from the insurance contract is the insured's expectation that his insurance company will not wrongfully deprive him of the very security for which he bargained or exposed him to the catastrophe from which he sought protection. Conduct by the insurer which does destroy the security or impair the protection purchased breaches the ... covenant of good faith and fair dealing implied in the contract.

Id. (citing *Rawlings v. Apodaca,* 151 Ariz. 149, 155, 726 P.2d 565, 571 (1986)).[4] Further under Mississippi law, even though an insurer may have an arguable reason for denying a claim, its course of conduct in denying that claim may nevertheless prove such an insult, fraud, oppression or reckless disregard for the rights of its insured, or show such willful, intentional wrong or such gross negligence or reckless conduct as to be the equivalent of such a wrong.

For instance, in *Independent Life and Accident Insurance. Co. v. Peavy*, 528 So.2d 1112 (Miss. 1988), the Mississippi Supreme Court held that though Independent Life had an arguable reason for refusing to waive the insured's premium, "the misrepresentations constituted either an intentional wrong or such gross negligence as to evidence reckless disregard for [the insured's]

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[3] In *Andrew Jackson*, the Mississippi Supreme Court noted that one example where an insurer could be held liable for punitive damages even where there is an arguable basis for denying coverage is "if the insured's financial straits and the relative unequal bargaining power of the parties were used as settlement leverage." *Andrew Jackson*, 566 So. 2d at 1179; *See also Travelers Indem. Co. v. Weatherbee*, 368 So.2d 829 (Miss. 1979). In Architex's case, Scottsdale has forced its insured to become bankrupt. If this is not a case for a jury trial of punitive damages, which should act to punish and deter future conduct, then what is to keep Scottsdale from subjecting contractors to this position in the future?

[4] *Rawlings v. Apodaca*, 151 Ariz. 149, 157, 726 P.2d 565, 573 (Ariz.,1986), "which has been cited by the [Mississippi Supreme Court] in other contexts, has held that an insurer whose claim was properly denied may nonetheless sue an insurer for bad faith where the process of denial indicated that the insurer was denying all claims without sufficient scrutiny. The Court explains, while the obligation of good faith does not require the insurer to relieve the insured of all possible harm that may come from his choice of policy limits, it does obligate the insurer not to take advantage of the unequal positions in order to become a second source of injury to the insured." See Jeffrey Jackson, MISSISSIPPI INSURANCE LAW AND PRACTICE, § 13:3 (2007).

rights," and thus warranted punitive damages. *See also Andrew Jackson Life Insurance Company v. Williams*, 566 So. 2d 1172, 1186 (Miss. 1990)("[A]n insurer who denies a claim on an arguable basis could conceivably be held liable for punitive damages for infliction of emotional distress through commission of sufficiently-repugnant acts in dealing with the insured and disputed claim."). Here, there is a mountain of evidence that indicates that even before denying coverage and defense, Scottsdale failed to act in good faith toward Architex, and failed to perform a proper investigation. In *Bankers Life & Casualty Company v. Crenshaw,* 483 So.2d 254 (Miss.1985), the Mississippi Supreme Court established that the denial of a claim without proper investigation may give rise to punitive damages. *Id.* at 276. The Court recognized that "an insurance company has a duty to the insured to make a reasonably prompt investigation of all relevant facts." *Id.*. See also, *Life and Casualty Insurance Co. of Tennessee v. Bristow,* 529 So.2d 620, 623-624 (Miss. 1988). In *Eichenseer v. Reserve Life Insurance Co.,* 682 F.Supp. 1355, 1366 (N.D.Miss.1988), the court found that under Mississippi law, before denying a medical claim, the insurer, at a minimum, must determine whether the policy provision at issue has been voided by a state or federal court, interview its agents and employees to determine if they have knowledge relevant to the claim, and make a reasonable effort to secure all medical records relevant to the claim. *Id.* at 1366.

But most akin to Scottsdale's failure to investigate herein is *Lewis v. Equity National Life Insurance Company,* 637 So.2d 183 (Miss. 1994). Where Equity National did not even undertake minimal inquiry into Mrs. Lewis' claim, the Mississippi Supreme Court reversed summary judgment for an insurer and submitted the question of bad faith to the jury. Though the insurer submitted a claim in May 1990, the insurer did not question its agent about the claim until *after* Lewis filed her lawsuit in January 1991. Further, Equity National admitted that it neither made an investigation nor requested any medical information regarding Mrs. Lewis'

claim or policy application before that date. Under these circumstances, the court held that the "evidence suggests that there exist questions of fact regarding the adequacy of Equity National's investigation of Mrs. Lewis' claim which should have been considered by a jury." *Id.* at 187.

Here, Scottsdale inexplicably failed to assign this claim to its construction defect group (Vol. 2, Ex. 15 at 44, 50, 51, and 54; RE 24); hired an investigator only to get a statement only from Vic Hamby although he was not the proper Architex representative (Vol. 1, Ex. 11, at 27, 32, 34-35, 41-43, 75-80; RE 11); never spoke with its hired investigator (Vol. 1, Ex. 11, at 71 and 72; RE 11); never interviewed the claimant or the claimant's attorney (Vol. 1, Ex. 9, at 58-71; RE 29); never inspected the property or the damages claimed; never requested additional documents, although Architex's counsel expressly stated that he had additional information regarding the claims (Vol. 1, Ex. 8; RE 29); allowed its "investigation" to lie completely dormant for six entire months even though Scottsdale claims that it had never actually seen the *Parshotham* Complaint or spoken with its insured (Vol. 1, Ex. 9 at 58-71; RE 28); then closed its file in June 2005, and only reopened the file in June 2006, when contacted by current counsel for Architex (*Id.* at 77-79, 85-87; RE 20); altogether failed and refused to investigate the mold and mildew claims, even after admitting in sworn testimony that such claims were potentially covered (*Id.*, at 98-108; RE 12; Vol. 2, Ex. 15 at 113-121; RE 30); and, despite its wholly inadequate investigation of any claims, has continued to refuse and fail to defend its insured.

There is more than ample evidence that Scottsdale failed in its "duty to the insured to make a reasonably prompt investigation of all relevant facts." *Crenshaw,* 483 So.2d at 276. Even now, Scottsdale has presented no evidence that it has performed **any** investigation of the mold and mildew claims. Therefore, the facts of this case are even more egregious than *Lewis v. Equity Nat. Life Ins. Co.*, 637 So.2d 183 (Miss. 1994).

The *Architex v. Scottsdale* bad faith question goes well beyond the issue of coverage--Scottsdale has exhibited tortious conduct since receipt of Architex's Notice of Claim, including a clear intent to deny Architex the benefit of its coverage, a failure to conduct ***any*** independent investigation of the file, a failure to testify to internal documents or to produce internal documents that expressly note the true reason for issuing CGL coverage is to protect a subcontractor's work, a failure to notify Architex of the reasons for denial *for over two years* and even today, a failure to make amends and show any remorse for its four years of improper (in)actions, which has left its insured financially destitute.

There can be no doubt that Mississippi state law allows recovery of extra-contractual damages in such a case as this. As noted by Professor Jackson:

> . . . Contractual remedies alone do not deter the insurer from resisting payment of valid claims, and if the insured were limited to only contractual recovery in insurance cases, the insurer might have the economic incentive to resist rather than to pay contract claims.
>
> Mississippi has recognized that the insured has extra-contractual remedies against the insurer. The most prominent of these remedies is a tort claim for bad faith where, in egregious cases, an insured may be able to recover punitive damages against the insurer. These extra-contractual remedies serve to deter an insurer from denying valid insurance claims, and serve also to punish the insurer through assessment of punitive damages. As the Mississippi Supreme Court noted in *Standard Life Insurance Company of Indiana v. Veal*:
>
> > [i]f an insurance company could not be subjected to punitive damages it could intentionally and unreasonably refuse payment of a legitimate claim with veritable impunity. To permit an insurer to deny a legitimate claim, and thus force a claimant to litigate with no fear that claimant's maximum recovery could exceed the policy limits plus interest, would enable the insurer to pressure the insured to the point of desperation enabling the insurer to force an inadequate settlement or avoid payment entirely.

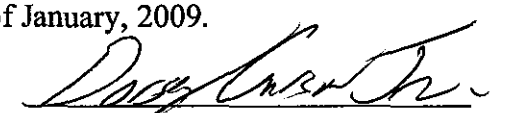
See Jeffrey Jackson, MISSISSIPPI INSURANCE LAW AND PRACTICE, § 13:3 (2007). Indeed, in this case, contractual remedies alone provide no disincentive for Scottsdale to repeat the outrageous conduct that it has displayed in this case.

CONCLUSION

For all of the reasons established hereinabove, this Court should find that negligent subcontractor construction defects that cause property damage and/or bodily injury are recognized as "occurrences" under CGL policies in Mississippi, and that Scottsdale has a duty to defend Architex in the underlying matter. Before this persistent litigation forced Architex out of business, Scottsdale received premiums specifically designated to cover subcontractor work and should rightfully be provided coverage as comtemplated by the contract.

WHEREFORE, PREMISES CONSIDERED, Architex Association, Inc. prays that this Court finds in its favor and orders Scottsdale to reimburse it for its attorney's fees and other costs associated in this matter, as well as well as any other relief this Court deems proper.

Respectfully submitted this the 20th day of January, 2009.



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CERTIFICATE OF SERVICE

I, Dorsey R. Carson, Jr., do hereby certify that a true and correct copy of the above and foregoing Brief of the Appellant has been sent via US Mail to the following:

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I, Dorsey R. Carson, Jr., do hereby certify that a true and correct copy of the above and foregoing Brief of the Appellant has been sent via US Mail to the following:

Honorable Kent McDaniel
Rankin County Court Judge
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This the 20th day of January, 2009.

DORSEY R. CARSON, JR.