THE STATE OF SOUTH CAROLINA
In the Supreme Court

Bennett & Bennett Construction, Inc. .....Respondent,

v.

Auto-Owners Insurance Co., Inc. .....Appellant.

Appellate Case No. 2011-183007

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S.C. Supreme Court

Appeal from Richland County
J. Ernest Kinard, Jr., Circuit Court Judge

RESPONDENT'S PETITION FOR REHEARING

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STATEMENT OF ISSUES ON REHEARING

I. DID THE COURT MISCONSTRUE EXCLUSION N?

II. IF NEWMAN CONSTRUED EXCLUSION N PROPERLY, DID THE COURT ERR IN ITS APPLICATION OF NEWMAN TO THESE FACTS?

III. DID THE COURT ERR IN CONSTRUING EXCLUSION J(5) TOO BROADLY AND CREATING A CONFLICT OR AMBIGUITY BETWEEN EXCLUSION J(5) AND EXCLUSION L?

IV. SMALL CONSTRUCTION BUSINESSES ARE PARTICULARLY VULNERABLE DURING THE PRODUCTS-COMPLETED OPERATIONS PHASE WHEN THE CGL POLICY PROVIDES ADDITIONAL COVERAGE.

REQUEST FOR REHEARING

Pursuant to Rules 221 and 240, SCACR, Respondent Bennett & Bennett Construction, Inc. respectfully petitions this Court to rehear this appeal. As set forth below, grounds for rehearing exist as there are particular factual and legal points which this Court has overlooked, misconstrued or misapprehended in issuing its ruling filed on July 17, 2013 (Opinion No. 27284).

ARGUMENT

I. THE COURT MISCONSTRUED EXCLUSION N.

The briefs in this appeal were filed in the Court of Appeals, months prior to the transfer of the appeal to this Court. Consequently, the briefs were written for a court which was bound by the holding in *Auto-Owners Ins. Co., Inc. v. Newman*, 684 S.E.2d 541, 385 S.C. 187 (2009). However, the Court's treatment of *Newman* in this case with

respect to exclusion (n) raises an issue which Respondent believes has not been addressed by this Court, either in the present case nor in *Newman* itself. There is a significant body of case law concerning exclusion (n), sometimes referred to as the "sistership" exclusion, which holds that the exclusion does not apply to damages from the product or work which was in use, but only excludes damages from the recall or withdrawal of "sister" products or work which have not failed. Because this issue is significant to construing exclusion (n) properly, Respondent asks that the Court consider the issue on rehearing in order to aid it in applying the correct principles of law.

In construing an insurance policy and its exclusions, *Newman* states that courts must consider the entire policy and adopt a construction that gives effect to each of the policy's various parts and provisions. 684 S.E.2d at 545. In construing exclusion (n), Respondent believes the Court erred by failing to consider the trailing language in exclusion (n). In *Newman*, the Court held that exclusion (n) barred coverage for the cost of removing and replacing the insured's work. The Court decided the issue relying upon the same language in exclusion (n) which the Court used in denying coverage in this appeal. *Newman* did not cite any case law construing exclusion (n), but relied upon its analysis of the language of the exclusion. However, *Newman* did not address the trailing language in exclusion (n) which limits the scope of the exclusion. That language limits the applicability of exclusion (n) to excluding those losses, costs or expenses incurred: "if such product, work or property is withdrawn or recalled from the market. . . ." [See exclusion (n) at R.192] This trailing language is significant, as there is an entire body of

law, which may not have been cited to this Court previously,[1] which limits exclusion (n) severely as a result of this language.

Exclusion (n) is known as the "sistership" exclusion. The name derives from a practice in the airline business in which planes similar to one which has crashed due to a defect, are recalled so that the suspect part can be corrected. *Olympic Steamship Co., Inc. v. Centennial Ins. Co.*, 117 Wash.2d 37, 42, 811 P.2d 673, 676 (Wash. 1991).

Numerous cases have held that a precondition of exclusion (n) is that it is intended to exclude from coverage the cost of preventive action by withdrawal of a product in situations in which a danger is to be apprehended in "sister" products but it is not intended to exclude from coverage damages caused by the very product whose failure aroused apprehension about the quality of the "sister" products. "Still less is it intended to exclude from coverage damages arising from the malfunctioning of a product where no 'sister' products are involved." *Parker Hannifin Corp. v. Steadfast Ins. Co.*, 445 F. Supp. 2d 827, 834 (N.D. Ohio 2006) quoting from *Todd Shipyards Corporation v. Turbine Service, Inc.*, 674 F.2d 401, 419 (5th Cir. 1982) (In *Todd*, the "sistership" exclusion was exclusion p.). Put another way, the sistership exclusion excludes coverage where because of failure of the insured's product, similar products are withdrawn from use to prevent

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[1] One example of the non-cited exclusion (n) case law, is *Auto-Owners Insurance Company v. Rhodes*, 385 S.C. 83, 682 S.E.2d 857 (Ct.App. 2009). In *Rhodes*, the Court of Appeals held that exclusion (n) is "typically included and applied to shield insurers from liability for the costs associated with unanticipated product recalls, and do not apply to claims involving losses resulting from the failure of the insured's product or work, when there is no evidence of a general recall of similar products or materials from the marketplace." *Id.* at 871. *Rhodes* was decided just before *Newman* was re-filed and was not cited in any of the *Newman* briefs.

their failure. "The exclusion applies only to the costs associated with the withdrawal and repair or replacement of 'sister' products which have not failed. It does not apply however, to the product that has already failed while in use and caused damage to the property of a third party." *U.S. Fid. & Guar. Co. v. Wilkin Insulation Co.*, 144 Ill.2d 64, 81, 578 N.E.2d 926, 934 (Ill. 1991). A thorough survey of the case law from numerous jurisdictions construing exclusion (n) to be limited to market recalls and withdrawals of work or products other than that which was damaged, can be found in *Todd Shipyards*, 674 F.2d at 419, and in the recent West Virginia case of *Cherrington v. Erie Ins. Property and Cas. Co.*, No. 12-0036, 2013 WL 3156003, at *15-*18 (W.Va. June 18, 2013).

Further supporting the construction of exclusion (n) as being limited to market recalls, is the language concerning the types of damages excluded. The exclusion is limited to claims for "loss, cost or expense" which are the types of harm incurred during recalls. However, unlike the property damage exclusions of (j)(1)-(7), (k),(l), and (m) which expressly exclude "Property damage" (R.191-192), there is no mention of "Property damage" in exclusion (n). (R.192) Instead, (n) excludes coverage of the losses and costs incurred in removing or recalling similar products which have not yet caused property damage. If the exclusion was intended to exclude "Property damage," the drafters certainly knew how to communicate that in exclusions (j) through (m). The choice of wording which limits the exclusion to losses, costs, and expenses, shows it was not the intent of the drafters to use exclusion (n) to exclude "Property damage."

In this case, the Court supported its construction of exclusion (n) as denying coverage for damage caused by the initial product or work, by citing to *Alverson v.*

Northwestern Nat. Cas. Co., 559 N.W. 2d 234, 236 (S.D. 1997). In *Alverson*, a mason damaged windows while cleaning up mortar on the windows. The damages arising from that cleaning were not covered by the CGL policy because the windows had to be replaced because the insured's work was incorrectly performed on the windows. Exsclusion j(6) is unrelated to exclusion (n), however, the exclusion which *Alverson* used to deny coverage was exclusion j(6). In fact, the language which the Court quotes from *Alverson*, is the language of exclusion j(6).[2] Obviously, the language cited from *Alverson* offers no guidance on the scope and application of exclusion (n) since exclusion (n) was not being addressed.

Since the damage in this case arises from the failure of the initial work or product, and not from the costs of recalling or removing similar products from service, exclusion (n) would not exclude the damages to the brick. The failure to address the trailing language means that the Court erred by not considering the exclusion as a whole, *Newman*, 684 S.E.2d at 545, and by taking language out of context. *Coletrain v. Coletrain*, 238 S.C. 555, 121 S.E.2d 89, 92 (1961). When considered as a whole, exclusion (n) is not applicable to this case.

II. IF NEWMAN CONSTRUED EXCLUSION N PROPERLY, THE COURT ERRED IN ITS APPLICATION OF NEWMAN TO THESE FACTS.

Alternatively, if the Court does not accept the previous argument, the decision still seems to be inconsistent with the holding in *Newman*. *Newman* held that there could be

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[2] In this case, the trial court found that exclusion j(6) was inapplicable and that there was coverage for the damage caused by the insured since the damage occurred during the products-completed operations stage. (R.17) Auto-Owners did not appeal the trial court decision as to exclusion j(6).

no recovery for removal of the defective work itself, but property damaged by defective work was covered and therefore recovery was appropriate. However, what was removed in this case was the decorative brick owned by BBCI which was damaged by the defective work. The Court's decision now casts confusion and doubt as to what *Newman* means.

Newman meant that only the removal of the defective work is excluded. However, the Court's analysis of exclusion (n) supports the proposition that exclusion (n) also bars coverage for damage to property caused by defective work. The Court erred in not holding that exclusion (n) does not bar coverage for the removal and replacement of the brick damaged by the defective work of the insured.

III. THE COURT ERRED IN CONSTRUING EXCLUSION J(5) TOO BROADLY AND CREATING A CONFLICT OR AMBIGUITY BETWEEN EXCLUSION J(5) AND EXCLUSION L.

Exclusion (l) excludes property damage to an insured's work arising out of the insured's work to which the Products-Completed Operations ("P-CO") hazard applies. However, exclusion (l), by its terms, does not exclude coverage for damage to the insured's work done by the insured's sub-contractors. Thus, exclusion (l) preserves generous coverage under P-CO for insureds who use subcontractors. In this case, the insured mason, M&M, would have coverage which would flow to BBCI under exclusion (l), since the damage to the M&M's work was done by its subcontractors. However, the Court's holding in this case, that exclusion j(5) also applies to completed operations, creates a conflict between exclusion j(5) and exclusion (l), since j(5) does not carve out the exception for subcontractors. Now, when a subcontractor harms the insured's work

during the P-CO phase, coverage is barred by exclusion j(5). Thus the coverage reserved by (l) for subcontractor's work during P-CO, no longer exists after the Court's decision.

This conflict results in an ambiguity in the policy language which must be construed in favor of coverage and in favor of the insured. Any ambiguity must be construed in favor of coverage and against the insurer. *Henderson v. Abbeville-Greenwood Mut. Ins. Assn.*, 96 S.C. 430, 81 S.E. 171 (1914). Where an insurance policy contains internal contradictions or repugnant clauses, the policy is rendered ambiguous and the court must resolve that ambiguity in favor of coverage. *BLG Enterprises, Inc. v. First Financial Ins. Co.*, 328 S.C. 374, 491 S.E.2d 695 (Ct.App. 1997), affirmed 334 S.C. 529, 514 S.E.2d 327 (1999).

M&M took down its scaffolding, left the job, sent BBCI an invoice, and stated its work was complete.[3] BBCI called M&M to return to the job and do corrective work. (R.8, FOF #4) The damage occurred one month after M&M left the job. Yet, the Court has now held that returning to perform corrective or warranty work, one month after completing work, is an on-going operation. Where is the line drawn where the passage of time is such that j(5) ends so that exclusion (l)'s preservation of coverage for acts by subcontractors applies? Two months? A year? Any answer to those questions would be arbitrary. By construing j(5) to apply after the P-CO coverage applies, the Court has given j(5) too broad of a construction, and created an ambiguity with exclusion (l).

If the Court were to construe exclusion j(5) not to apply to completed operations, the conflict with exclusion (l) would be resolved. It would then be clear that exclusion

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[3] (R.8, FOF#4)

j(5) applied to on-going operations before work was "completed," and exclusion (l) would apply to work done after the job was deemed "complete." In *American States Insurance Company v. Powers*, 262 F.Supp.2d 1245, 1251 (D.Kan.2003), the District Court stated, "In other words exclusion j(5) applies to damages involving 'works in progress' and does not apply to completed operations." Construing exclusion j(5) narrowly would be appropriate since exclusions are to be construed strictly against the insurer, *Abernathy v. Prudential Ins. Co. of America*, 274 S.C. 388, 264 S.E.2d 836 (1980), and are to be construed narrowly and in favor of coverage. *McPherson By and Through McPherson v. Michigan Mut. Ins. Co.*, 310 S.C. 316, 426 S.E.2d 770 (1993).

IV. SMALL CONSTRUCTION BUSINESSES ARE PARTICULARLY VULNERABLE DURING THE PRODUCTS-COMPLETED OPERATIONS PHASE WHEN THE CGL POLICY PROVIDES ADDITIONAL COVERAGE

At the end of a job, when the work is substantially complete and the finishes are installed, small contractors are particularly vulnerable to property damage. For most contractors, there is little money left in their contracts with which to fund repairs, and finishes are often very expensive to correct or repair, compared to other items of construction. As an example, in the case of BBCI, its insured mason could not afford to repair the marred appearance of the bricks. BBCI, the general contractor, had to spend a year's revenues to repair the brick since Auto-Owners refused to fund the repairs. (R. 82) Very few small construction firms can survive that kind of unexpected expense.

It is in this context that the Products-Completed Operations coverage in the CGL policy needs to be construed. P-CO coverage is triggered when the work is deemed

"complete," which is at the point that the building is substantially complete, or is being used for its intended purpose. In other words, P-CO coverage is triggered at the very point that these small firms are most vulnerable. The P-CO coverage provides coverage after work is deemed "complete" that is not available prior to the work being deemed "complete." Coverage which is excluded by exclusion j(6), becomes available once the work is "complete" and P-CO coverage is triggered, since the policy states that j(6) does not exclude property damage covered by P-CO. (R.192) This coverage applies even to damage to the insured's own work. Exclusion (l) applies to damage to the insured's own work during the P-CO phase. However, because in today's market many small contractors rely heavily on subcontractors, exclusion (l) provides coverage since it does not exclude damage to the insured's work during the P-CO phase of the work, if the damage is caused by the insured's subcontractor. Exclusion (m) is another example when damage to the insured's work gives rise to damages which are covered after operations are "completed." The exclusion, which denies coverage to impaired property, allows coverage for loss of use when sudden damage occurs to the insured's work after it has been put to its intended use (one of the tests for P-CO coverage.)

When the Court, in its Conclusion, states as a general rule that "a CGL policy does not insure the insured's work itself but consequential risks that stem from the insured's work," adherence to that general rule is error during the P-CO phase. Once the P-CO coverage is triggered, there are exceptions to the general rule in which the parties to the CGL policy have agreed that the CGL policy will insure damage to the insured's work or consequences arising therefrom. And, as argued by Respondent, exclusion j(5) is

another exception to the Court's general rule, once P-CO coverage is triggered, in that it no longer excludes coverage.

CONCLUSION

In conclusion, BBCI petitions the Court to vacate its opinion and to issue a new opinion affirming the trial court and finding coverage in favor of BBCI.

Respectfully submitted,

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August 1, 2013

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J. Ernest Kinard, Jr., Circuit Court Judge

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CERTIFICATE OF SERVICE

I certify that on this day I served a copy of the Respondent's Petition for Rehearing on John L. McCants by leaving a copy of same addressed to John L. McCants with an employee at the offices of Rogers, Lewis, Jackson, Mann & Quinn, LLC, at 1330 Lady Street, Suite 400, Columbia, SC 29201.

James Williams

August 1, 2013