THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM BERKELEY COUNTY
Court of Common Pleas

Roger M. Young, Sr., Circuit Court Judge

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Case No. 2014-CP-08-02757

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Portrait Homes – South Carolina, LLC and
Portrait Homes – Persimmon Hill, LLC; Plaintiffs,

v.

Pennsylvania National Mutual Casualty Insurance Company
and The Persimmon Hill Homeowners Association, Inc., Defendants,

AND

The Persimmon Hill Homeowners Association, Inc., Third-Party Plaintiff,

v.

Jose Castillo d/b/a JJA Framing and
JJA Construction, Inc. d/b/a JJA Framing, Third-Party Defendants,

Of which Pennsylvania National Mutual Casualty Insurance Company is the Appellant,

And

Portrait Homes – South Carolina, LLC, Portrait Homes – Persimmon Hill, LLC,
and The Persimmon Hill Homeowners Association, Inc. are the Respondents.

Appellate Case No. 2020-000735

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# FINAL REPLY BRIEF OF APPELLANT

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## INTRODUCTION

The canons of insurance policy construction in South Carolina rest on several bedrock principles, including (1) the insured has a duty to comply with the conditions contained in an insurance policy in order for coverage to be afforded; (2) every insured has the duty to read his or her insurance policy and acquaint himself or herself with its contents; (3) an insurance policy is to be construed according to its plain, unambiguous terms; and (4) extrinsic evidence cannot be used to create an ambiguity in an insurance policy where none exists. The trial court in this case, however, ignored these well-established principles in order to manufacture a result wherein Respondents were entitled to receive almost $25 million from Pennsylvania National Mutual Casualty Insurance Company ("Penn National"), even though the liability limits available under all potentially applicable policies of insurance issued by Penn National totaled $4 million. Such a result cannot stand. This Court is now tasked with reviewing the confusing, precedent-disregarding, and unnecessarily complicated decisions rendered by the trial court, and instilling rationality back into the decisions rendered in this case.

Adherence to the fundamental principles of insurance policy construction compels the conclusion that Penn National has no coverage for the judgment entered against its insureds, and therefore is not liable for the claims of the judgment-creditor, Respondent The Persimmon Hill Homeowners Association, Inc. ("HOA"), and that Respondents Portrait Homes – South Carolina, LLC and Portrait Homes – Persimmon Hill, LLC (collectively, "Portrait Homes") were never covered under the Penn National Policies as "additional insureds." Penn National respectfully requests that this Court reverse the erroneous legal conclusions reached by the trial court, vacate the judgments entered against Penn National, and direct that judgment be entered in favor of Penn National on all claims.

## ARGUMENT AND ANALYSIS

### I. There Is No Coverage Under The Penn National Policies For The Default Judgment Entered Against The Penn National Insureds Because The Insureds Clearly Breached Their Duties Under The Penn National Policies, Resulting In Substantial Prejudice To The Insurer.

The trial court in this case found that coverage was afforded under eight policies of insurance issued by Penn National and therefore awarded the HOA, as judgment-creditor, $4 million, the full amount of coverage under each policy of insurance, as well as $1,213,170.40, the interest on the entirety of the default judgment, for a total of $5,213,170.40. In so doing, the trial court disregarded the fundamental tenants that (1) an insured is obligated to comply with the duties ascribed to it in the insurance policy as a condition of coverage; and (2) an insured has the duty to read and be acquainted with its policy of insurance.

For ease of reference, Penn National reminds the Court of the Penn National Policies at issue in the present appeal:

| *Policy No.* | *Effective Dates* | *Named Insured* | *Occurrence Limit* | *A.I. Endors.* | *A.I.* | *Reference* |
|---|---|---|---|---|---|---|
| GL9 060617 | 12/05/02 – 12/05/03 | Jose Castillo d/b/a JJA Framing | $500,000 | None relevant | | 2002-03 Policy |
| GL9 060617 | 12/05/03 – 12/05/04 | Jose Castillo d/b/a JJA Framing | $500,000 | CG 2037 | Pasquinelli Construction Co.; Pasquinelli Management, LLC; Portrait Homes Construction Co. | 2003-04 Policy |
| GL9 060617 | 12/05/04 – 12/05/05 03/02/05[1] | Jose Castillo d/b/a JJA Framing JJA Construction, Inc. | $500,000 | CG 2037 | Pasquinelli Construction Co.; Pasquinelli Management, LLC; Portrait Homes Construction Co. | 2004-05 Policy |
| GL9 060617 | 12/05/05 – 12/05/06 | JJA Construction, Inc. | $500,000 | 71 1145 | Named in contract with Named Insured | 2005-06 Policy |
| GL9 060617 | 12/05/06 – 12/05/07 | JJA Construction, Inc. | $500,000 | 71 1145 | Named in contract with Named Insured | 2006-07 Policy |
| GL9 060617 | 12/05/07 – 01/31/08 | JJA Construction, Inc. | $500,000 | 71 1145 | Named in contract with Named Insured | 2007-08 Policy |
| GL9 | 07/09/08 – | JJA Framing Co. | $500,000 | None | | 2008 Policy |

[1] On this date, the named insured on the Policy was changed to JJA Construction, Inc.

| | | | | | | |
|---|---|---|---|---|---|---|
| 0649575 | 11/03/08<br>8/15/08[2] | JJA Construction, Inc. | | | | |
| GL9<br>0649575 | 07/09/09 –<br>07/09/10 | JJA Construction, Inc. | $500,000 | None | | 2009-10 Policy |

### A. It Is Undisputed That The Penn National Insured Both Failed And Refused To Comply With Policy Conditions.

It is axiomatic that insurers have the right under their insurance policies to limit their liability and impose conditions on their obligations as long as the limitations and conditions do not violate statutory provisions or public policy. *B.L.G. Enter. v. First Fin. Ins. Co.*, 334 S.C. 529, 535-36, 514 S.E.2d 327, 330 (1999). The Penn National Policies all contained the same conditions, which stated:

**SECTION IV – COMMERCIAL GENERAL LIABILITY CONDITIONS**

**2. Duties In The Event Of Occurrence, Offense, Claim Or Suit**

**a.** You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim. To the extent possible, notice should include:
- **(1)** How, when and where the "occurrence" or offense took place;
- **(2)** The names and addresses of any injured persons and witnesses; and
- **(3)** The nature and location of any injury or damage arising out the "occurrence" or offense.

**b.** If a claim is made or "suit" is brought against any insured, you must:
- **(1)** Immediately record the specifics of the claim or "suit" and the date received; and
- **(2)** Notify us as soon as practicable.

You must see to it that we receive written notice of the claim or "suit" as soon as practicable.

**c.** You and any other involved insured must:
- **(1)** Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit";
- **(2)** Authorize us to obtain records and other information;
- **(3)** Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and
- **(4)** Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which

this insurance may also apply.

**d.** No insured will, except at the insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

[Plaintiffs' Exh. 14, pp.48-49 (RII pp. 726-727); Plaintiffs' Exh. 17, pp.30-31 (RII pp. 793-794); Plaintiffs' Exh. 21, pp.49-50 (RII pp. 869-870); Plaintiffs' Exh. 27, pp.40-41 (RII pp. 933-934); Plaintiffs' Exh. 29, pp.42-43 (RIII pp. 990-991)].[2] Accordingly, under the Penn National Policies, the Named Insured had the duty to: (1) notify Penn National *as soon as practicable* of an "occurrence" which may result in a claim against it; (2) provide *written* notice to Penn National *as soon as practicable* of a lawsuit brought against it, including providing dates of service; (3) *immediately* send copies to Penn National of any demands, notices, summons, or legal papers received in connection with any lawsuit; and (4) cooperate with Penn National in the defense of the lawsuit. See also, *Pennsylvania Nat'l Mut. Cas. Ins. Co. v. Castillo*, 2019 U.S. Dist. LEXIS 49319, *6 (W.D.N.C. 2019)(enumerating these conditions in the same Penn National Policies and granting judgment in favor of Penn National because Castillo failed to comply with these provisions with regard to a different lawsuit).

South Carolina courts have universally found that similar notice and cooperation clauses are valid and enforceable. *Neumayer v. Philadelphia Indem. Ins. Co.*, 427 S.C. 261, 266, 831 S.E.2d 406, 408 (2019). It is uncontroverted that Jose Castillo was personally served with the Complaint in the Persimmon Hill Litigation on September 8, 2013. At no time did Mr. Castillo, or anyone else associated with JJA Framing or JJA Construction, Inc., either provide written

[2] HOA emphasizes that Penn National failed to cite the amendments to these Conditions contained in an endorsement to the Penn National Policies when citing these Conditions to its insureds. The endorsement merely made clear that the Condition 2.b. under the Policies will not be deemed to be breached unless the insured, either individually or an officer of the corporation, knew about the claim or "suit" and failed to provide notice. In the present case, it is undisputed that the Underlying Lawsuits were personally served on Jose Castillo, who was the Named Insured under several Policies and an officer of the corporation under the remaining Policies.

notice to Penn National of the Persimmon Hill Litigation or send copies of the Summons and Complaint to Penn National. Under South Carolina law, this clear and undisputed breach of the notice provision in the Penn National Policies obviated all coverage under the Penn National Policies for Jose Castillo d/b/a JJA Framing and JJA Construction, Inc. in the Persimmon Hill Litigation. See, *Prior v. South Carolina Med. Mal. Liab. Ins. Joint Underwriting Ass'n*, 305 S.C. 247, 250, 407 S.E.2d 655, 657 (Ct.App. 1991)(the named insured's failure to provide notice of the underlying lawsuit for four months after he was served violated the policy and precluded coverage); *Hatchett v. Nationwide Mut. Ins. Co.*, 244 S.C. 425, 435, 137 S.E.2d 608, 613 (1964)(finding that it is "well settled" that the insured's failure to adhere to the notice provisions will bar recovery under the policy).

After Penn National was notified of the Persimmon Hill Litigation by Portrait Homes (as a result of their demand for "additional insured" coverage under the Penn National Policies), Penn National hired an independent adjuster, Gayle McLeod, to determine if the Penn National Named Insureds were served with the Persimmon Hill Litigation. Penn National learned on February 19, 2014 from its own investigation that Mr. Castillo had been personally served with the Persimmon Hill Litigation over five months earlier. Although it was not required to do so under the Penn National Policies, Penn National directed Ms. McLeod to find Mr. Castillo. Ms. McLeod came to Mr. Castillo's residence on two separate occasions. On March 26, 2014, Ms. McLeod came to Mr. Castillo's residence, left notes on his front door and on both vehicles parked at the residence requesting that Mr. Castillo contact Ms. McLeod, and also left contact information with a neighbor. [HOA Exh.7 (RIII p. 1228)] It is undisputed that Mr. Castillo did not contact Ms. McLeod as a result of this visit.

Ms. McLeod again attempted to meet with Mr. Castillo on May 15, 2014. At that time,

Ms. McLeod saw Mr. Castillo in his garage and approached him. Ms. McLeod identified herself and stated that she was there on behalf of Mr. Castillo's insurer, Penn National, regarding the Persimmon Hill Litigation. McLeod testified that she explained that the Persimmon Hill Litigation papers named Mr. Castillo individually. Ms. McLeod requested that Mr. Castillo contact Penn National immediately about the Persimmon Hill Litigation and provided him with the Penn National adjuster's name and contact information. Mr. Castillo told Ms. McLeod that he no longer operated JJA Construction, and that he was not interested in defending against the lawsuit. **Significantly, Mr. Castillo stated that he did not want Penn National to defend him in the Persimmon Hill Litigation.** Ms. McLeod asked Mr. Castillo for his contact information so that Penn National could speak with him directly. Mr. Castillo did not provide his information to Ms. McLeod. Mr. Castillo then walked inside his house, closing the door behind him and effectively terminating his conversation with Ms. McLeod. [HOA Exh. No. 10 (RIII p. 1232); Trial Transcript, Vol. 1 at 407:6-408:8 (RI pp. 348-349); Trial Transcript, Vol. 2 at 91:18-97:20, 386:2-9 (RI pp. 427-432, 472)].

After this interaction between Mr. Castillo and Ms. McLeod, Mr. Castillo did not cooperate with Penn National by calling the Penn National adjuster as requested by Ms. McLeod. It is undisputed that Mr. Castillo **never** called Penn National to discuss the Persimmon Hill Litigation at any time. In fact, there is no evidence that Mr. Castillo took any affirmative actions at all to comply with his duties and obligations under the Conditions of the Penn National Policies. Because Mr. Castillo failed to cooperate with Penn National, no coverage is afforded to him under the Penn National Policies for the Persimmon Hill Litigation. *Tucker v. State Farm Mut. Auto Ins. Co.*, 232 S.C. 615, 622, 103 S.E.2d 272, 276 (1958).

Despite this undisputed evidence, the trial court found that none of the actions taken, or

not taken, by Mr. Castillo are relevant to this issue of whether Mr. Castillo breached his duties to notify and cooperate with Penn National. In support of the trial court's decision, the HOA urges this Court to focus not on the inactions of Mr. Castillo but on the actions that theoretically could have been taken by Penn National to contact Mr. Castillo. However, the Penn National Policies impose affirmative duties on the insured, with which the insured is required to comply in order for coverage to be afforded. *Neumayer*, 427 S.C. at 265-66, 831 S.E.2d at 408. When the insured fails to fulfill its duties under the policies, coverage is not afforded under the policy. See, *Hatchett*, 244 S.C. at 435, 137 S.E.2d at 613.

The HOA argues that it does not matter that Mr. Castillo did not provide written notice of the Persimmon Hill Litigation to Penn National as soon as practicable or immediately send to Penn National copies of the Summons and Complaint served on him. The HOA claims that because Penn National received copies of the Persimmon Hill Litigation from a third-party, i.e. Portrait Homes, that the insured's duty to notify Penn National was satisfied. However, the HOA was unable to cite to a single case to support this conclusion.

Indeed, all the authority in South Carolina is to the contrary. In *Merit Ins. Co. v. Koza*, 274 S.C. 362, 264 S.E.2d 146 (1980), the Supreme Court was tasked with determining whether the insurance company properly denied coverage for a claim because the insured never forwarded suit papers as required under the policy. As a result of a suit instituted against the insured, the insured's truck was impounded under an order of attachment. *Id.* at 363, 264 S.E.2d at 147. The insured informed the insurer of the attachment, and the adjuster was able to get the insured's truck released. Ultimately, a default judgment was entered and the insurer denied coverage. The insured argued that because the insurer had actual knowledge of the lawsuit, the insured waived the notice provision in the policy. The Supreme Court rejected this argument:

> [I]n our opinion, mere knowledge by the Insurance Company of the fact that process has been served upon the insured does not of itself amount to a waiver or an estoppel. There must exist, in addition to such knowledge, where the papers have not been forwarded to the Insurance Company as provided in the contract, some positive act upon which, in connection with the knowledge a waiver may be predicated. And, this positive act must be known to the insured.

*Id.* at 365, 264 S.E.2d at 147-48. The insured argued that the insurer's actions in communicating with opposing counsel regarding the release of the truck constituted this "positive act." The Supreme Court also rejected this argument, finding that these communications were "insufficient to lull the insured into believing he did not have to fulfill his contractual obligations to forward the suit papers." *Id.* at 366, 264 S.E.2d at 148.

The HOA tries to differentiate the Supreme Court's holding in *Merit* by arguing that in that case, the insurer never received a copy of the suit papers, while in the present case, Portrait Homes forwarded to Penn National a copy of the Persimmon Hill Litigation. This is a distinction without a difference. The *Merit* decision is based on the fact that the insurance company had actual knowledge of the lawsuit. The holding in *Merit* is that the insurer's mere knowledge of the lawsuit, however acquired, does not waive the insured's duty to fulfill his contractual obligation to forward the suit papers to the insurer. *Id.* See also, *Founders Ins. Co. v. Richard Ruth's Bar & Grill*, 761 Fed.Appx. 178, 183 (4th Cir. 2018)("Even where an insurer has actual knowledge of a potential claim or occurrence triggering coverage under the policy, the insured is not relieved of his contractual obligation to provide the legal papers to the insurer unless the insurer waives that policy provision."); *Greenwood Dev. Corp. v. Cincinnati Ins. Co.*, 2012 U.S. Dist. LEXIS 204018, *28-29 (D.S.C. 2012)("In South Carolina, even if an insurer is otherwise aware of a lawsuit against its insured, if the insured's failure to forward to the insurer a copy of the lawsuit (or otherwise provide notice of the lawsuit) substantially prejudices the insurer, the notice and cooperation clauses preclude coverage.").

There was no evidence presented, and the trial court never found, that Penn National waived the insured's contractual obligation to both provide written notice of the Persimmon Hill Litigation and to immediately forward the Summons and Complaint served on him. Without such evidence, the insured was required to fulfill his contractual obligation. Because he failed to do so, there is no coverage under the Penn National Policies for the Persimmon Hill Litigation.

When Ms. McLeod first went to Mr. Castillo's residence, she left information requesting that Mr. Castillo call her. Mr. Castillo did not. When she met with him in person, she requested that Mr. Castillo call the Penn National adjuster immediately. Mr. Castillo never did. Ms. McLeod requested that Mr. Castillo provide her with his contact information so that the Penn National adjuster could call him. Mr. Castillo refused to do so. Even if this Court should affirm the trial court's findings and conclusions that Mr. Castillo did not have to comply with the notice provisions of the Penn National Policies, Mr. Castillo's breach of his contractual obligation to cooperate with Penn National bars all coverage for him under the Penn National Policies.[3]

The HOA argues that the trial court appropriately found that Mr. Castillo, on behalf of himself and JJA Construction, Inc. did not waive their right to a defense under the Penn National Policies. This argument, however, misses the mark. Coverage, including the duty to defend, was not denied based on an argument that Mr. Castillo somehow waived his right to a defense under the Policies. Coverage, and the duty to defend, was obviated when Mr. Castillo failed to comply with his contractual obligations to provide written notice of the Persimmon Hill Litigation as soon as practicable, to immediately send copies of the Summons and Complaint to

[3] The HOA argues, based on testimony from Mr. Castillo at trial, that Mr. Castillo would have done anything that Penn National asked him to do and would have provided information if Ms. McLeod had only asked. This after-the-fact testimony is clearly inconsistent with Mr. Castillo's actions at the time. The uncontroverted evidence is that Mr. Castillo did not call Penn National or provide his contact information to Ms. McLeod as he was specifically requested to do. In fact, Mr. Castillo ended the conversation with Ms. McLeod when he walked into his house and closed the door on Ms. McLeod while she was still on his property.

Penn National, and to cooperate with Penn National in the defense of the Persimmon Hill Litigation. "[B]reach of an insurance policy's notice clause automatically relieves the insurer of its obligations under the contract, including the payment of proceeds due, and the duty to defend and to indemnify the insured." *Wright v. UNUM Life Ins. Co.*, 2001 U.S. Dist. LEXIS 26063, *4 (D.S.C. 2001).

### B. It Is Undisputed That The Insured's Breach Of Its Duties To Provide Notice And Cooperate Resulted In A Default Judgment And Prejudice To Penn National.

The breach of the insured's duties under an insurance policy bars coverage for the insured for the claim or lawsuit. *Hatchett*, 244 S.C. at 435, 137 S.E.2d at 613. Under South Carolina law, however, where the rights of an innocent party are jeopardized by the failure of the insured to comply with its obligations under the policy, the insurer must show substantial prejudice to its rights before coverage of benefits to the third-party can be denied. *Factory Mut. Liability Ins. Co. v. Kennedy*, 256 S.C. 376, 381, 182 S.E.2d 727, 729-30 (1971). In the present case, Penn National showed that it was substantially prejudiced by its insured's failure to comply with its contractual duties as a matter of law.

The undisputed evidence showed that the insured did not communicate at all with Penn National after being served with the Persimmon Hill Litigation, did not call when notes requesting that he do so were left at his residence, and did not call the Penn National adjuster when asked to do so. It is uncontroverted that when asked whether he wanted Penn National to provide a defense in the Persimmon Hill Litigation, Mr. Castillo responded "no."

Because Castillo refused a defense of the Persimmon Hill Litigation, Penn National believed that it could not retain an attorney to defend him. Penn National's belief was based on the South Carolina Rules of Professional Conduct. Rule 1.8(f)(1) states, "A lawyer shall not

accept compensation for representing a client from one other than the client unless: the client gives informed consent." Rule 1.8, RPC, Rule 407, SCACR. At no time did Mr. Castillo give consent to Penn National to represent him or JJA Construction in the Persimmon Hill Litigation. In fact, he expressly declined such representation. Therefore, Penn National believed that it was prevented from retaining an attorney to represent its insureds. See, *Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Bev. Co.*, 433 F.3d 365, 374 (4th Cir. 2005)("Of course, an insured must consent to the counsel assigned by the insurance company."); *State Nat'l Ins. Co. v. Eastwood Constr.*, 2018 U.S. Dist. LEXIS 232022, *32 (D.S.C. 2018)("[The insured] is correct that an insured must consent to counsel assigned by the insurance company.").

The HOA contends that Penn National had its insureds' consent to retain an attorney to represent them in the Persimmon Hill Litigation because consent can be implied from the purchase of the insurance policy. However, the HOA did not cite to any South Carolina law in effect at that time for that proposition. In fact, there is none. The fact remains that under the Rules of Professional Conduct, an attorney cannot represent an insured without his consent.

Mr. Castillo did not retain an attorney to represent either himself or JJA Construction in the Persimmon Hill Litigation. Therefore, no appearance was made on behalf of Jose Castillo d/b/a JJA Framing and JJA Construction, Inc. in the Persimmon Hill Litigation and a default judgment was entered against both defendants in the amount of $4,156,976.89.

South Carolina appellate courts have consistently held that a default judgment resulting from the insured's failure to comply with its contractual obligations under the insurance policy constitutes substantial prejudice as a matter of law. See, e.g., *Merit*, 274 S.C. at 364, 264 S.E.2d at 147; *Neumayer*, 427 S.C. at 273 n.6, 831 S.E.2d at 412 n.6.

The HOA argues that because Penn National had actual knowledge of the Persimmon

Hill Litigation before the default judgment was entered, the entering of the default judgment did not substantially prejudice Penn National. However, Penn National was unable to stop the entering of the default judgment precisely because its insureds refused to allow Penn National to hire counsel to defend them. See, *Tucker*, 232 S.C. at 624, 103 S.E.2d ay 277 (affirming denial of coverage where the insured "simply tied the hands of the insurance company in the defense of that action."). See also, *CAMICO Mut. Ins. Co. v. Jackson CPA Firm*, 2016 U.S. Dist. LEXIS 177122 (D.S.C. 2016)(finding that the insurer suffered substantial prejudice from the insured's failure to notify of malpractice claims even though insurer was notified prior to the institution of the lawsuit).

Lastly, the HOA argues that Penn National waived its argument that it could not have hired counsel to represent its insureds in the Persimmon Hill Litigation because Penn National's position was not included in the reservation of rights letters or denial letter sent to Mr. Castillo, relying on *Harleysville Group Ins. v. Heritage Cmtys*, 420 S.C. 321, 803 S.E.2d 288 (2017). The trial court's conclusion of waiver is unfounded. In *Harleysville*, the Supreme Court held that a reservation of rights letter must give fair notice to the insured of the bases in the policy on which the insurer intends to rely as defenses to coverage. *Id.* at 338, 803 S.E.2d at 297. In the present case, Penn National consistently cited to the "Duties In The Event Of Occurrence, Claim or Suit" in each of the reservation of rights and ultimate denial of coverage letters sent to the insureds. [HOA Exh. No. 14 (RIII p. 1246)] This was the policy provision on which Penn National based its denial of coverage in this case. The fact that Penn National was precluded from retaining an attorney to represent its insureds is evidence of how Penn National was substantially prejudiced by the insured's breach of its contractual obligations. Neither the *Harleysville* Court nor any other court has held that the insurer must detail the prejudice it suffered in a reservation of rights

or denial of coverage letter. Indeed, the HOA failed to cite to any.

The undisputed evidence at trial was that the Penn National insured failed to take any affirmative actions to comply with its duties under the Penn National Policies. When Penn National tracked the insured down, which it was not required to do under its Policies, the insured expressly declined a defense from Penn National to the Persimmon Hill Litigation. Therefore, Penn National's "hands were tied" and it could not retain an attorney to represent the insured in the Persimmon Hill Litigation. The insured continued to do nothing and a default judgment was entered against the insureds in the Persimmon Hill Litigation. Penn National was therefore substantially prejudiced by the insureds' breach of its contractual obligations and Mr. Castillo's failure to allow Penn National to represent the insureds in the Persimmon Hill Litigation. The trial court's conclusion that the HOA as judgment creditor is entitled to coverage under the Penn National Policies constitutes error. This Court should reverse the trial court's judgment against Penn National and in favor of the HOA and enter judgment in Penn National's favor as a matter of law.

## II. Penn National Had A Reasonable Basis To Deny Coverage To Its Insureds And Therefore The Judgment Against Penn National For Bad Faith Cannot Stand.

The elements of a bad faith claim are: (1) the existence of a valid insurance policy; (2) the insurer's refusal to pay benefits due under the policy; (3) resulting from the insurer's bad faith or unreasonable action in breach of an implied covenant of good faith and fair dealing; and (4) which causes damages to the insured. *Crossley v. State Farm Mut. Auto. Ins. Co.*, 307 S.C. 354, 359, 415 S.E.2d 393, 396-97 (1992). "If there is reasonable ground for contesting a claim, there is no bad faith." *Id.* at 360, 415 S.E.2d at 397. Whether reasonable grounds existed for the denial depends on the circumstances existing at the time of the denial. *Howard v. State Farm Mut. Auto. Ins. Co.*, 316 S.C. 445, 448, 450 S.E.2d 582, 584 (1994).

In the present case, it is clear that at the time that Penn National made the decision to deny coverage to its insureds, there existed reasonable grounds to do so. The insureds failed to comply with their contractual obligations to provide written notice of the Persimmon Hill Litigation as soon as practicable after being served, to immediately send copies of the Summons and Complaint served upon them, and to cooperate. Penn National's denial of coverage was reasonable. See, *Pennsylvania Nat'l Mut. Cas. Ins. Co. v. Castillo*, 2109 U.S. Dist. LEXIS 49319, *13 (W.D.N.C. 2019)(finding under identical circumstances that "coverage is not afforded to the JJA Defendants for the claims asserted against them in the Underlying Construction Defect Litigation because the JJA Defendants failed to comply with the conditions for coverage under the Penn National Policies."). Accordingly, the trial court's failure to grant judgment in favor of Penn National on the bad faith claimed assigned by the Penn National insureds to the HOA constitutes error.

The HOA fails to show how Penn National's coverage decision was unreasonable based on the information known to Penn National at the time of the decision. Instead, the HOA diverts this Court's attention by claiming that Penn National made alleged misrepresentations of the policy benefits to Mr. Castillo. In support of this contention, the HOA points to evidence that Ms. McLeod did not tell Mr. Castillo that (1) the Persimmon Hill Litigation was a multi-million dollar claim; (2) that the insureds' defense in the Persimmon Hill Litigation was a policy benefit for which he already paid; and (3) Penn National's alleged abandoning of a defense after Penn National requested an extension of time from the HOA for Mr. Castillo and JJA Construction to respond to the Persimmon Hill Litigation before an entry of default was taken against them. None of this conduct can support a bad faith claim.

First, Penn National did not have the duty to affirmatively provide any of the listed

information to Mr. Castillo. Under South Carolina law, the insured has the duty to read his insurance policy and understand the contents therein, including the obvious fact that the insurer's duties under the insurance policy includes a defense. *Doub v. Weathersby-Breeland Ins. Agency*, 268 S.C. 319, 326-27, 233 S.E.2d 111, 114 (1977). See also, *Lewis v. OMNI Indem. Co.*, 970 F.Supp.2d 437, 449 (D.S.C. 2013)("It is well settled in South Carolina that an insured has the duty of reading his insurance policy and of acquainting himself with its contents.").

Further, Mr. Castillo had the information regarding his work on the buildings at issue in the Persimmon Hill Litigation and the potential extent of his liability. At the time that Penn National made the decision to deny coverage to its insureds, the only thing that Penn National knew about the Persimmon Hill Litigation came from the Amended Complaint it received from Portrait Homes. Mr. Castillo had superior knowledge of the potential extent of his liabilities with regard to the Persimmon Hill Litigation because he actually worked on the project.

Lastly, Penn National did not undertake a defense of Jose Castillo d/b/a JJA Framing and JJA Construction in the Persimmon Hill Litigation. It never retained an attorney to represent Jose Castillo d/b/a JJA Framing and JJA Construction who entered an appearance. The only thing that Penn National did was to request the HOA defer its entry of default against Jose Castillo and JJA Construction for thirty days while Penn National tried to contact its insureds through Ms. McLeod. The trial court's finding that Penn National somehow undertook a defense is not supported by the evidence.

Conspicuously, the HOA fails to even address Penn National's argument in its initial brief that none of the bad conduct attributed to Penn National by the court in this case formed the basis for Penn National's decision to deny coverage to Jose Castillo d/b/a JJA Framing and JJA Construction in the Persimmon Hill Litigation. Without this necessary showing, the bad faith

judgment against Penn National cannot stand. As the federal court reasoned:

> If courts allowed insureds to create a genuine issue of material fact on a bad faith processing claim by engaging in a "nit-picky" analysis of each action the insurance adjuster took or did not take in handing claims, every bad faith action would survive a motion for summary judgment. There must still be an evaluation of the reasonableness of the insurer's conduct …

*Founders Ins. Co. v. Richard Ruth's Bar & Grill*, 2016 U.S. Dist. LEXIS 74432, *31 (D.S.C. 2016)(emphasis in original).

Finally, an essential element of a bad faith claim is that the insured suffered damages resulting from Penn National's conduct. Once it determined that Penn National's conduct amounted to bad faith, the trial court did not undergo any analysis of what damages were actually caused by Penn National's allegedly bad faith conduct. Instead, the trial court merely found that Penn National engaged in bad faith and awarded the HOA, as assignee of the Penn National insureds' bad faith claim, the entirety of the default judgment entered against the Penn National insureds, plus interest accrued. The HOA was required to present evidence of the damages caused by Penn National's alleged bad faith conduct "with reasonable certainty or accuracy." *Magnolia N. Prop. Owners Ass'n v. Heritage Cmtys.*, 397 S.C. 348, 374, 725 S.E.2d 112, 126 (Ct.App. 2012). For example, the HOA was required to prove, if Penn National had not wrongfully denied coverage, that the judgment against Jose Castillo d/b/a JJA Framing or JJA Construction would have been less than the default judgment actually entered against them. The HOA presented no such evidence. To the contrary, the HOA contended that its judgment against the Penn National Insureds was justified and would have been entered even if they had been defended. Therefore, the trial court's judgment of bad faith damages amounts to nothing more than conjecture, guess or speculation, which is insufficient as a matter of law to support the bad faith judgment. *Piggy Park Enter. v. Shofield*, 251 S.C. 385, 391, 162 S.E.2d 705, 708 (1968).

Without some evidence to show that the particular conduct found to be bad faith on behalf of Penn National resulted in the entirety of the default judgment against the Penn National insureds, such a verdict cannot stand. See, *Liberty Mut. Fire Ins. Co. v. JT Walker Indus.*, 554 Fed.Appx. 176, 188 (4th Cir. 2014)(finding that bad faith damages were improper where insured did not prove what damages were sustained from the bad faith conduct); *State Nat'l Ins.*, 2018 U.S. Dist. LEXIS 232022 at *67 (directing judgment to insurer after bench trial on bad faith claims because insured failed to show that any damages resulted from the insurer's denial of defense).

## III. There Is No Coverage For Portrait Homes Under The Penn National Policies Because The Penn National Policies Clearly And Unambiguously Did Not Provide Coverage To Portrait Homes As An Additional Insured.

A fundamental tenet of insurance policy construction is: "When a contract is unambiguous, clear, and explicit, it must be construed according to the terms the parties have used." *B.L.G. Enter.*, 334 S.C. at 535, 514 S.E.2d at 330. Because an insurance policy is to be interpreted according to the language contained therein, "[t]he court's duty is limited to the interpretation of the contract made by the parties themselves regardless of its wisdom or folly, apparent unreasonableness, or failure of the parties to guard their interests carefully." *Id.* "An insurer's obligation under a policy of insurance is defined by the terms of the policy itself, and cannot be enlarged by judicial construction." *MGC Mgmt v. Kinghorn Ins. Agency*, 336 S.C. 542, 549, 520 S.E.2d 820, 823 (Ct.App. 1999).

The trial court in this case failed to follow these bedrock principles when it relied on extrinsic evidence to find that ambiguities existed in the Penn National Policies regarding whether Portrait Homes was entitled to additional insured coverage. Portrait Homes argues that "latent" ambiguities exist in the policy forms that justified the trial court's reliance on extrinsic evidence to manufacture coverage. However, an insurance policy is ambiguous only if it "may

be fairly and reasonably be understood in more ways than one." *Goldston v. State Farm Mut. Auto. Ins. Co.*, 358 S.C. 157, 170, 594 S.E.2d 511, 518 (Ct.App. 2004). Whether an insurance policy is ambiguous is based on the language contained in the policy itself. *Harbin v. Williams*, 429 S.C. 1, 8, 837 S.E.2d 491, 495 (Ct.App. 2019). Extrinsic evidence may not be used to create an ambiguity where none exists. *Yarborough v. Phoenix Mut. Life Ins. Co.*, 266 S.C. 584, 591-92, 225 S.E.2d 344, 348 (1976).

### A. The Clear And Unambiguous Language Of The Additional Insured Endorsement, Form CG 2037, Mandates That Portrait Homes Was Not An Additional Insured Under The 2003-04 Policy And The 2004-05 Policy.

Whether Portrait Homes qualified as an additional insured under the 2003-04 Policy and the 2004-05 Policy is dictated solely by the terms of the additional insured endorsement attached to these policies. These Policies contained Form CG 2037, entitled, "Additional Insured – Owners, Lessees or Contractors – Completed Operations." This endorsement states:

> Section II – Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of "your work" at the location designated and described in the schedule of this endorsement performed for that insured and included in the "products-completed operations hazard."

[Plaintiffs' Exhs. 14, pp.18-20 (RII pp. 696-698); Plaintiffs' Exh. 17, p.4 (RII p. 767)] Identified in the Schedule are only the following entities: Pasquinelli Construction Co., Pasquinelli Management LLC and Portrait Homes Construction Company. This is not disputed.

The Persimmon Hill Litigation did not assert claims against Pasquinelli Construction Co., Pasquinelli Management LLC or Portrait Homes Construction Company. Because the additional insureds actually named in the Schedule of the endorsement were not named as defendants in the Persimmon Hill Litigation, there is no additional insured coverage available under the 2003-04 Policy and the 2004-05 Policy. The defendants named in the Persimmon Hill Litigation were

Portrait Homes – South Carolina, LLC and Portrait Homes – Persimmon Hill, LLC. However, neither of these two entities was named in the Schedule of the CG 2037 endorsement. Therefore, neither Portrait Homes – South Carolina, LLC nor Portrait Homes – Persimmon Hill, LLC are entitled to additional insured coverage under the 2003-04 Policy and the 2004-05 Policy. Adhering to the bedrock principles of insurance policy construction, the trial court's determination should have ended here and judgment should have been entered in Penn National's favor on Portrait Homes' claim for additional insured coverage under these two Policies.

It is important to note that the trial court did not find the language of the CG 2037 endorsement ambiguous. Instead, the trial court decided to interpret the language according to testimony given at trial regarding the corporate structure of the Pasquinelli/Portrait Homes organization. Based on this testimony, the court found that the "parties" intended that all organizations under the Pasquinelli/Portrait Homes umbrella, regardless of location, were covered under the CG 2037 endorsement. Missing from this "analysis" is any evidence that Penn National, as a party to the Penn National Policies, ever intended such broad coverage when it issued the 2003-04 Policy and the 2004-05 Policy. See, *Schulmeyer v. State Farm Fire & Cas. Co.*, 353 S.C. 491, 495, 579 S.E.2d 132, 134 (2003)(indicating that the intention of the parties to the insurance policy must be gleaned from the actual contractual language used). In fact, the undisputed evidence was that Penn National charged premium for each location noted in the CG 2037 endorsement. Clearly, Penn National did not intend to extend such broad additional insured coverage without charging any premium.

Even Portrait Homes distances itself from the trial court's analysis regarding the plain terms of CG 2037 endorsement. Instead, Portrait Homes argues that a "latent" ambiguity exists,

not in the names listed in the schedule of the CG 2037 endorsement, but in the locations indicated on the endorsement. This, according to Portrait Homes, then allowed the trial court to consult extrinsic evidence. Portrait Homes' argument misses the mark. There is no coverage under the CG 2037 endorsement precisely because the entities specifically named in the endorsement were not sued in the Persimmon Hill Litigation. If the entities actually identified in the CG 2037 endorsement had been sued, it may be a relevant inquiry as to whether the location on the CG 2037 endorsement was clear or ambiguous. But, because the entities actually listed on the CG 2037 endorsement were not sued in the Persimmon Hill Litigation, any errors regarding the location are irrelevant and cannot be used to make otherwise clear policy language ambiguous.

### B. The Clear And Ambiguous Language Of The Additional Insured Endorsement, Form 71 1145, Mandates That Portrait Homes Was Not An Additional Insured Under The 2005-06 Policy, the 2006-07 Policy, And The 2007-08 Policy.

A different additional insured endorsement was used in the 2005-06 Policy, the 2006-07 Policy and the 2007-08 Policy. In these Policies, Form 71 1145 was used to provide additional insured coverage. This form, entitled "Automatic Additional Insureds – Owners, Contractors and Subcontractors (Completed Operations)," stated in pertinent part:

> A. The following provision is added to SECTION II – WHO IS AN INSURED:
>
> > 6. Any person(s) or organization(s) (referred to below as additional insured) with whom you are required in a written contract or agreement to name as an additional insured for the "products-completed operations hazard", but only with respect to liability for "bodily injury" or "property damage" caused, in whole or in part, by "your work", at the location or project designated and escribed in the contract or agreement, performed for that additional insured and included in the "products-completed operations hazard".

[Plaintiffs' Exh. 21, p.29 (RII p. 849); Plaintiffs' Ex. 27, p.20 (RII p. 913); Plaintiffs' Exh.29,

p.23 (RIII p. 971)] As the language in this endorsement makes clear, additional insured coverage is extended to those organizations whom "you" are contractually bound to provide such coverage for completed operations. "You" is a specifically defined term in the Penn National Policies:

> Throughout this policy the words "you" and "your" refer to the Named Insured shown in the Declarations, and any other person or organization qualifying as a Named Insured under this policy.

[Plaintiffs' Exh. 21, p.40 (RII p. 860); Plaintiffs' Exh. 27, p.31 (RII p. 924); Plaintiffs Exh. 29, p.33 (RIII p. 981)] The Declarations pages of these three policies identify the Named Insured as JJA Construction, Inc. [Plaintiffs' Exh. 21, p.2 (RII p. 822); Plaintiffs' Exh. 27, p.2 (RII p. 895); Plaintiffs' Exh. 29, p.2 (RIII p. 950)]

Accordingly, under the 2005-06 Policy, the 2006-07 Policy and the 2007-08 Policy, additional insured coverage is only afforded to those organizations that JJA Construction, Inc. contractually agreed to add as additional insureds for completed operations. It is undisputed that JJA Construction, Inc. did not enter into any written contracts in which it agreed to provide additional insured coverage for Portrait Homes for completed operations. The trial court should have ended its construction of the 2005-06 Policy, the 2006-07 Policy and the 2007-08 Policy here and granted judgment in favor of Penn National regarding Portrait Homes' claim for additional insured coverage.

Again, instead of adhering to the canons of insurance policy construction to determine this issue, the trial court manufactured coverage for Portrait Homes by looking to Penn National's underwriting file to determine whether Jose Castillo d/b/a JJA Framing can be considered to be a Named Insured under these Penn National Policies. The trial court erred in so doing. "Parties to a contract have the right to construct their own contract without interference from courts to rewrite or torture the meaning of the policy to extend coverage." *Schulmeyer*, 353

S.C. at 495, 579 S.E.2d at 134.

In order to manufacture coverage for Portrait Homes under these three policies, the trial court constructed a house of cards consisting of the following: (1) contrary to the plain language of the Policies, the Named Insured was not just JJA Construction, Inc. but also Jose Castillo d/b/a JJA Framing; AND (2) Jose Castillo d/b/a JJA Framing entered into a Housing and Purchase Order Contract ("Purchase Order") with Portrait Homes – South Carolina, LLC regarding the construction at Persimmon Hill, but that contract did not require Jose Castillo d/b/a JJA Framing to purchase additional insured coverage for completed operations;[4] AND EITHER (3) the Master Agreement, signed by Jose Castillo d/b/a JJA Framing after the Purchase Order, which by its terms only applied to prospective purchase order contracts, actually applied to the previously entered Purchase Order; OR (4) an earlier master agreement existed and was signed by Jose Castillo d/b/a JJA Framing identical to the later dated Master Agreement even though no such agreement was ever introduced as an exhibit at trial and no one who has ever seen or read such a prior agreement testified at trial; AND (5) the Purchase Order and a version of the Master Agreement constitute a single contract.[5]

As with a true house of cards, if any one of these contentions is not true, then the whole house falls and, even under the trial court's tortuous construction, the Penn National Policies do not provide additional insured coverage to Portrait Homes.

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[4] And, therefore, cannot satisfy the requirements of the 71 1145 endorsement.

[5] To meet the requirements of the 71 1145 endorsement, the contract entered into by the Named Insured must both require that Portrait Homes be added as an additional insured for completed operations and identify the project on which the Named Insured performed work. The Purchase Order is the only contract that describes Jose Castillo d/b/a JJA Framing's work at Persimmon Hill, but the Purchase Order does not require additional insured coverage for completed operations for Portrait Homes. The Master Agreement, if applicable, requires additional insured coverage for completed operations for Portrait Homes, but does not describe work to be performed by Jose Castillo d/b/a JJA Framing at any location, including at Persimmon Hill. Therefore, in order to meet the requirements of the 71 1145 endorsement, the trial court necessarily had to find that both contracts, though executed at disparate times, constituted one contract.

The Named Insured under the 2005-06 Policy, the 2006-07 Policy, and the 2008-09 Policy is JJA Construction. Jose Castillo d/b/a JJA Framing is not listed as a named insured anywhere in the declarations or in any endorsement. There is no ambiguity regarding the identity of the "Named Insured" under these Policies. Portrait Homes argues that because JJA Construction constituted the same business that was previously operated as Jose Castillo d/b/a JJA Framing, that Jose Castillo d/b/a JJA Framing should qualify as a Named Insured under the Penn National Policies. This argument overlooks the simple fact that JJA Construction is NOT the same business as Jose Castillo d/b/a JJA Framing. JJA Construction is a corporation duly incorporated under the laws of North Carolina, owned not only by Jose Castillo but jointly owned by Mr. Castillo and his son. Jose Castillo d/b/a JJA Framing is a sole proprietorship. These two entities are separate and are viewed as such under the law.

This Court's decision in *Mangum v. Maryland Cas. Co.*, 330 S.C. 573, 500 S.E.2d 125 (Ct.App. 1998) is instructive. In *Mangum*, Maryland issued a garage policy to Bob's, Inc. Bob's, Inc. was a closely held corporation whose sole shareholders were Mr. and Mrs. Magnum. The Magnum's son sought to stack underinsured motorist (UIM) coverage under the Maryland policy after he was injured in an accident. Only Class I insureds, defined as named insureds under a policy, are eligible to have UIM coverage stacked. Because the Magnum's were not the named insured under the policy, Maryland denied additional coverage. The Magnum's argued that as sole shareholders of the corporation, they should qualify as Class I insureds because they are the same as the named insured. This Court disagreed:

> A corporation is not a natural person and maintains a separate and distinct identity apart from its shareholders. This oft-stated principle is equally applicable, whether the corporation has many or only one shareholder.

*Id.* at 576, 500 S.E.2d at 127. This Court affirmed the denial of coverage.

Similarly, here, the Named Insured under the Penn National Policies was a corporation. Therefore, the only entity that qualified as a "you" under the Policies was JJA Construction, and not Jose Castillo d/b/a JJA Framing. Portrait Homes argues that because JJA Construction did business as JJA Framing, it was the same entity as Jose Castillo d/b/a JJA Framing, citing *Auto-Owners Ins. Co. v. Rhodes*, 405 S.C. 584, 748 S.E.2d 781 (2013). *Rhodes* is readily distinguished.

In *Rhodes*, a judgment was entered against "Marion L. Eadon d/b/a C&B Fabrication." The insurance policies at issue were issued to two separate corporations, C&B Fabrication, Inc. and Low Country Signs, Inc. Both the insurer and the insured stipulated that the named insureds under both policies should be reformed to include "d/b/a C&B Fabrication." *Id.* at 599, 748 S.E.2d at 789. The court found that because the judgment was entered in the trade name, there was coverage under policies which were also issued in the same trade name. *Id.* at 600, 748 S.E.2d at 789. That is not the present situation. The Named Insured under the 2005-06 Policy, the 2006-07 Policy and the 2007-08 Policy is the corporation only. The Named Insured is NOT JJA Construction d/b/a JJA Framing. Therefore, *Rhodes* is inapplicable.

There is no document admitted into evidence that indicates that JJA Construction was doing business as JJA Framing. For example, there was no addendum to either the Purchase Order or the Master Agreement that changed the contracting party's name from Jose Castillo d/b/a JJA Framing to JJA Construction. To now argue, as Portrait Homes does, that the Purchase Order and the subsequent Master Agreement, executed by Jose Castillo d/b/a JJA Framing, should be construed as binding JJA Construction is wholly unsupported and contrary to South Carolina law. "Interpretation of a contract is governed by the objective manifestation of the parties' assent at the time the contract was made, rather than the subjective, after-the-fact

meaning one party assigns to it." *North Am. Rescue Prods. v. Richardson*, 411 S.C. 371, 378, 769 S.E.2d 237, 241 (2015).

Even assuming arguendo that JJA Construction can be bound by contracts to which it was not a party, the only contract that governed the work performed at Persimmon Hill was the Purchase Order. It is undisputed that the Purchase Order did not require that Portrait Homes be included as an additional insured for completed operations. Therefore, it does not meet the requirements of the 71 1145 endorsement.

To get around this obvious deficiency, the trial court found that the Master Agreement, which required that additional insured coverage for completed operations be provided to Portrait Homes, applied to change the terms of the Purchase Order. However, the Master Agreement actually admitted into evidence at trial was dated after the Purchase Order, and only applied to prospective contracts, contrary to the arguments of Portrait Homes.[6] Because the Purchase Order was executed by the parties eight months prior to the execution of the Master Agreement, the Master Agreement did not apply to change the terms of the Purchase Order.

Undeterred, the trial court found that there must have been a previous master agreement that applied to change the terms of the Purchase Order. However, this earlier master agreement was never entered into evidence at trial. No one who had read or drafted any earlier drafts of the master agreement testified at trial. The finding by the trial court that an earlier master agreement existed, that such an earlier agreement was actually executed by Jose Castillo, and that the earlier

[6] Indeed, in arguing that the Master Agreement applied to the previously executed Purchase Order, Portrait Homes quotes a selective portion of one of the provisions contained in the Master Agreement. (Portrait Homes' Brief, p.23) The sentence preceding the quote contained in Portrait Homes' brief is: "In order to expedite the use of Contractor's services and/or materials each time they are needed, the parties agree to enter into and comply with this Agreement ***prior*** to any actual services being performed pursuant to any purchase order contract." (emphasis added) Portrait Homes' argument wholly ignores other clear provisions in the Master Agreement which make its terms prospective only, including "the terms of this Agreement shall prevail in the event of any conflict between the terms of this Agreement and any ***future*** purchase order contract …" [Plaintiffs' Exh. 37, p.1, ¶1 (RIII p. 1141)](emphasis added)

agreement required additional insured coverage for completed operations for Portrait Homes is wholly unsupported by any evidence at trial.

The house of cards constructed by the trial court to manufacture coverage for Portrait Homes under the 71 1145 endorsement contained in the 2005-06 Policy, the 2006-07 Policy and the 2007-08 Policy cannot stand. Penn National requests that this Court reverse the trial court's decision.

### C. Even If Portrait Homes Qualified As An Additional Insured Under The Penn National Policies, Which Penn National Disputes, Portrait Homes Did Not Prove That It Suffered Any Damages Resulting From Penn National's Breach Of Its Policies.

Portrait Homes brought one claim against Penn National, specifically for breach of contract. In the Amended Complaint, Portrait Homes sought the following damages:

> 28. As a proximate result of Penn National's breach of contract, Plaintiff has been damaged in the amount of the attorney fees and expenses incurred in defending the Portrait Entities in the Persimmon Hill Litigation, and in the amount of the funds required to obtain the settlement.

(Am. Compl., p.5 (RI p. 220)) Portrait Homes does not dispute that its own insurer, Admiral Insurance Company, paid for its defense in the Persimmon Hill Litigation. According to well-established law, Portrait Homes is not entitled to payment of its defense costs which another insurance company has funded. *Sloan Constr. Co. v. Central Nat'l Ins. Co.*, 269 S.C. 183, 189, 236 S.E.2d 818, 821 (1977)("The insured was not damaged because it was afforded a defense by Liberty.").

It is also undisputed that Portrait Homes did not pay any money towards the settlement of the Persimmon Hill Litigation; all settlement funds were paid by either Admiral or other insurance companies. There was no evidence presented at trial that Portrait Homes must reimburse either Admiral or the other insurers for the amount paid to settle the Persimmon Hill

Litigation. Portrait Homes cannot maintain a breach of contract claim against Penn National when it cannot show that it was damaged as a result of any contract breach. See, *Branche Builders v. Coggins*, 386 S.C. 43, 48, 686 S.E.2d 200, 202 (Ct.App. 2009)("The elements for breach of contract are the existence of the contract, its breach, and damages caused by such breach."); *Collins Entm't v. White*, 363 S.C. 546, 560, 611 S.E.2d 262, 269 (Ct.App. 2009)(affirming direct verdict because any calculation of damages by jury on plaintiff's breach of contract claim would have been pure speculation).

On appeal, Portrait Homes argues that from the judgment obtained against Penn National, it will refund Admiral for the amounts it paid to settle the Persimmon Hill Litigation.[7] No evidence, however, was admitted at trial that supports this bald assertion by Portrait Homes on appeal. There was no evidence, documentary or otherwise, that Admiral and Portrait Homes entered into an agreement whereby Portrait Homes agreed to reimburse Admiral for its settlement payments. Copies of the Admiral policy were not entered into evidence to substantiate that Admiral possesses any rights with regard to any recovery in this case. Without such evidence, this Court cannot assume that Portrait Homes will reimburse Admiral for the payments it made towards the settlement of the Persimmon Hill Litigation.

The trial court found that Portrait Homes was entitled to damages resulting from Penn National's alleged breach of the duty to indemnify because the funds paid by Admiral and other insurers constituted a collateral source, relying on *Otis Elevator v. Hardin Constr. Co.*, 316 S.C. 292, 450 S.E.2d 41 (1994). However, *Otis Elevator* addressed indemnification rights among tortfeasors, and did not address the situation of contribution among insurers. In fact, the holding

[7] Interestingly, Portrait Homes does not make the same contention regarding the funds paid by the other insurers who contributed to the settlement of the Persimmon Hill Litigation. To prevent a windfall for Portrait Homes, if this Court should affirm the damages entered by the trial court for breach of contract, this Court should mandate a credit for all sums paid by other insurers towards the settlement in the Persimmon Hill Litigation.

of *Otis Elevator* has never been applied by any other court to govern contribution rights among multiple insurance carriers. Indeed, the only courts who have considered *Otis Elevator* in the insurance context have rejected its applicability. See, *Summer Wood Prop. Owners Ass'n v. Pennsylvania Nat'l Mut. Cas Ins. Co.*, 2019 U.S. Dist. LEXIS 157353, *17-19 (D.S.C. 2019); *Pennsylvania Nat'l Mut. Cas. Ins. Co. v. Portrait Homes – South Carolina*, 2019 U.S. Dist. LEXIS 160414, *18-19 (W.D.N.C. 2019).

Damages from a breach of contract serve to put the non-breaching party in the position he would have been in if the contract been performed. *Branche Builders*, 386 S.C. at 48, 686 S.E.2d at 202. Applying the collateral source rule would contravene this principle by awarding the non-breaching party more damages than necessary to compensate it for the breach, constituting an impermissible windfall. *Crossmann*, 2013 U.S. Dist. 138941 at *82.

Portrait Homes was unable to prove that it suffered any damages resulting from Penn National's alleged breach of its duty to indemnify. Therefore, on this separate basis, the trial court erred in failing to grant judgment in favor of Penn National on Portrait Homes' breach of contract claim.

## IV. Penn National Had A Reasonable Basis To Deny Coverage To Portrait Homes And Therefore The Judgment Against Penn National For Bad Faith Cannot Stand.

As indicated above, the touchstone for a bad faith claim is whether the insurer's coverage denial was based on reasonably objective grounds as viewed at the time that the decision was made. *Crossley*, 307 S.C. at 360, 415 S.E.2d at 397; *Howard*, 316 S.C. at 448, 450 S.E.2d at 584. As indicated above, Penn National made the decision to deny additional insured coverage to Portrait Homes based on the plain language contained in the two additional insured endorsements attached to the Penn National Policies. Because Penn National's denial of coverage was based on reasonable grounds, this Court should vacate the judgment entered in

favor of the HOA, as assignee of Portrait Homes' bad faith claim, and grant judgment in favor of Penn National.

Significantly, Portrait Homes did not prove that it suffered any damages resulting from any alleged bad faith conduct of Penn National. As indicated above, an essential element of a bad faith claim is that the insured suffered damages resulting from the bad faith conduct. Again, the trial court did not undergo any analysis of what damages were suffered by Portrait Homes as a result of Penn National's allegedly bad faith conduct. Instead, the trial court merely found that Penn National engaged in bad faith and awarded the entirety of the settlement amount paid by Portrait Homes in the Persimmon Hill Litigation. However, the undisputed evidence was that Portrait Homes did not suffer any damages resulting from Penn National's alleged bad faith conduct. At all times, Portrait Homes was being defended in the Persimmon Hill Litigation by its own insurance carrier and the entirety of the settlement paid was funded by insurance carriers.[8] Because there is no support for the bad faith damages assessed against Penn National, this judgment should be vacated. See, *Liberty Mut.*, 554 Fed.Appx. at 188; *State Nat'l*, 2018 U.S. Dist. LEXIS 232022 at *67.

## V. The Trial Court's Allocation Of Damages Ignored Supreme Court Precedent In Order To Award The Entirety Of Coverage Available Under All Penn National Policies.

Coverage under the Penn National Policies is not afforded for all damages sought in the Persimmon Hill Litigation. The Penn National Policies only provide coverage for "property damage" caused by an "occurrence" as those terms are defined in the Penn National Policies. "In sum, we clarify that negligent or defective construction resulting in damage to otherwise non-defective components may constitute "property damage," but the defective construction

[8] Indeed, Portrait Homes never asserted a bad faith claim against Penn National. This claim was asserted by the HOA, on behalf of Portrait Homes, in its Second Amended Answer and Cross-claim.

would not." *Crossman Cmtys. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 50, 717 S.E.2d 589, 594 (2011).

In the Persimmon Hill Litigation, the HOA sought damages caused by the faulty workmanship of the construction of the townhouses resulting from improper design; failure to inspect during the construction process; failure to adhere to the building code and construction industry standards; and use of improper materials. The HOA also sought damages resulting from breach of warranty and unfair trade practices. All of these damages would not be covered as "property damage" caused by an "occurrence" under the Penn National Policies.

> [I]mproper or faulty construction, including code violations, missing component parts, improper choice of component materials, defective design, failure to adhere to building plans and specifications and failure to adhere to manufacturer specifications fail to meet the insurance policy's definition of "property damage" and are therefore not covered under the provisions of a commercial general liability policy.

*Crossmann Cmtys v. Harleysville Mut. Ins. Co.*, 2013 U.S. Dist. LEXIS 138941,*51 (D.S.C. 2013). See also, *Builders Mut. Ins. Co. v. Lacey Constr.*, 2012 U.S. Dist. LEXIS 41588, *30 (D.S.C. 2012)(CGL policies not cover damages from breach of warranty and unfair trade practices claims). Therefore, Penn National would only be liable to indemnify the HOA and Portrait Homes for that portion of the default judgment and settlement attributable to "damage to otherwise non-defective components." The HOA, as judgment-creditor, and Portrait Homes had the burden of proving what portion of the default judgment and settlement constituted "property damage" caused by an "occurrence." *Builders Mut. Ins. Co. v. Island Pointe,* 2020 S.C. LEXIS 68, *9-10 (S.C. 2020).

In the present case, neither the HOA nor Portrait Homes presented any evidence of what portion of the judgment or settlement constituted covered damages. The trial court erroneously found that they did not have to, finding that a general verdict obviated the need to segregate the

damages into covered and non-covered damages. Failure to find how much of the judgment and settlement were attributable to otherwise covered damages constitutes error requiring this Court to vacate the judgment in this case. As the Supreme Court recently noted, the parties have the burden of showing in a coverage action, "which portions of the general verdict are covered under the CGL policies." *Id.* at *9.

The damages complained of in the Persimmon Hill Litigation constituted progressive damages that occurred over a period of time. Therefore, after determining how much of the default judgment and settlement constituted covered damages under the Penn National Policies, the trial court should have allocated those covered damages based on the time-on-risk method adopted by the Supreme Court in *Crossmann II*. The trial court refused to do so. Instead, the trial court created a new unprecedented method of allocating damages in order to ensure that the liability limits contained on all Penn National Policies were paid.

Although the trial court never explained how it reached its conclusion that the limits of each Penn National Policy was to be paid, Portrait Homes attempted to do so in its Brief. The method, as explained by Portrait Homes, is confusing and arbitrary. Using the same examples that Portrait Homes referenced in its Brief, for one unit, 172 Darcy, all damages are to be attributed to a single policy period encompassing the date that the damages first occurred, the 2003-04 Policy, while for another unit, 184 Darcy, all damages are to be attributed not to the first policy period during which the damages first occurred, the 2005-06 Policy, but to a policy several years later, the 2007-08 Policy. This Court should not affirm the muddled method used by the trial court to allocate damages across the Penn National Policy periods.[9]

Instead, if this Court finds any coverage at all, it should vacate the judgment entered

[9] From its example, it appears that Portrait Homes is advocating a return to the joint and several method of allocation specifically rejected by the Supreme Court in *Crossmann II*. See, 395 S.C. at 60, 717 S.E.2d at 599.

against Penn National and require the trial court to utilize the method adopted by the Supreme Court in *Crossmann II* and universally applied thereafter by the South Carolina courts:

> The basic formula consists of a numerator representing the number of years an insurer provided coverage and a denominator representing the total number of years during which the damage progressed. This fraction is multiplied by the total amount the policyholder has become liable to pay as damages for the entire progressive injury. In this way, each triggered insurer is responsible for a share of the total loss that is proportionate to its time on the risk.

*Crossmann II*, 395 S.C. at 65, 717 S.E.2d at 602.

Portrait Homes attempts to justify the trial court's refusal to follow Supreme Court precedent by arguing that the Penn National Policies contained language different from the language in the CGL policies considered in *Crossmann II*. Portrait Homes' argument is misguided. In *Crossmann II*, the Supreme Court was tasked with determining an allocation method for progressive damages cases. In doing so, it fashioned a method which took into consideration relevant policy language, case law, the objectively reasonable expectations of the contracting parties, and important policy goals. *Id.* at 52-63, 717 S.E.2d at 595-601.

> In sum, we construe the standard CGL policy to require that each insurer cover only that portion of a loss attributable to property damage that occurred during its policy period. In light of the difficulty in proving the exact amount of damage incurred during each policy period, we adopt the formula above as the default method for allocating shares of the loss. Trial courts may vary from this default formula where appropriate to the circumstances of a particular case, ***but they must remain faithful to the premise that each insurer is responsible only for a pro rata portion of the total loss, and each pro rata portion must be defined by the insurer's time on the risk.***

*Id.* at 66, 717 S.E.2d at 603 (emphasis added).

If this Court affirms the trial court's divergence from the *Crossmann II* mandate, the only logical alternative is to default to a method of allocation addressed in *Joe Harden Builders v. Aetna Cas. & Sur. Co.*, 326 S.C. 231, 486 S.E.2d 89 (1997), not to create a new method of allocation as the trial court did. It is clear that the trigger of coverage under a CGL policy would

remain the same, i.e. injury-in-fact. Therefore, the only other method of allocation discussed in *Joe Harden* that also uses injury-in-fact as the trigger of coverage is "coverage triggered at the time of an injury-in-fact:"

> Under this theory, coverage is triggered whenever the damage can be shown in fact to have first occurred, even if it is before the damage became apparent, and the policy in effect at the time of the injury-in-fact covers all the ensuing damages.

*Id.* at 236, 486 S.E.2d at 91. Using this alternative method, only the first Penn National Policy in effect when the injury-in-fact occurred would be triggered for all ensuing damages. Claims of defective construction arising out of negligent construction constitute a single occurrence. *Auto Owners Ins. Co. v. Newman*, 385 S.C. 187, 194, 684 S.E.2d 541, 544 (2009). Therefore, only the first policy in effect when the damages first occurred resulting from the Penn National Named Insured's negligent construction, the 2002-03 Policy, is triggered for all ensuing damages.[10] Therefore, the maximum liability for Penn National is the single Policy limits of $500,000.[11] If this Court finds that the policy language contained in the Penn National Policies requires a repudiation of the *Crossmann II* time-on-the-risk method, this Court should nonetheless vacate the judgment against Penn National and direct that only the 2002-03 Policy is triggered for all ensuing damages.

## VI. The Trial Court Improperly Trebled Damages When It Awarded Damages For Bad Faith And The Exact Same Amount As Punitive Damages.

In assessing damages for claims of bad faith, a court may award damages proximately caused by the bad faith conduct and punitive damages for conduct that was willful, wanton or

[10] If this method was to be adopted by this Court, then Portrait Homes does not have coverage as an additional insured because the 2002-03 Policy does not contain an additional insured endorsement that is even potentially applicable.

[11] Portrait Homes argues that all coverage should not be limited to one policy period as the words, "first occurred," is not contained in the Penn National Policies. This is inconsequential as this method of allocation is based on the description of the trigger of coverage contained in *Joe Harden*.

reckless in disregarding the insured's rights. *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983). However, the HOA and Portrait Homes had the burden of proving any alleged misconduct by Penn National and any ensuing damages by clear and convincing evidence. S.C. Code Ann. §15-33-135; *Austin v. Specialty Transp. Servs.*, 358 S.C. 298, 313, 594 S.E.2d 867, 875 (Ct.App. 2004). The HOA and Portrait Homes failed to meet their burden of proof in this case. As opposed to analyzing the evidence, the trial court just awarded the amount it already awarded as bad faith damages as punitive damages, in effect assessing treble damages against Penn National. The trial court's actions were improper and should be reversed by this Court.

In its Brief, the HOA, beneficiary of any punitive damages award, does not even point to evidence of any conduct by Penn National constituting willful, wanton or reckless indifference or the damages proximately caused thereby. Instead, it merely argues that Penn National did not preserve this issue for appeal. This is not true. Penn National properly preserved this issue on appeal. In its Order As to Persimmon Hill Homeowner's Association, Inc.'s Claims, the trial court found that punitive damages would be assessed against Penn National. [HOA Order, p.44 (RI p. 49)] In its Motion to Alter or Amend Judgment pursuant to Rule 59, Penn National specifically listed as a basis of its motion that "the trial court failed to find by clear and convincing evidence that Penn National engaged in willful, reckless or wanton conduct or that Penn National acted in willful and reckless disregard of Portrait Homes (or Castillo's or JJA Construction, Inc.'s) policy rights and, as such, its award of punitive damages is proper." [Rule 59 Motion, pp.5, 6-7 (RV pp. 1822, 1823-1824)][12]

[12] Throughout its Brief, the HOA consistently argues that Penn National failed to preserve issues on appeal. This is just not true. Penn National raised all issues it now argues on appeal with the trial court, both during the bench trial and in its Rule 59 motion. See, [Penn National's Proposed Order (RIV p. 1651); HOA's Proposed Order (RIV p.

Because the HOA and Portrait Homes failed to prove that Penn National engaged in willful, wanton or reckless conduct by clear and convincing evidence, and any resulting damages by clear and convincing conduct, this Court should vacate the punitive damages award and enter judgment in Penn National's favor.

## CONCLUSION

The cardinal rules of insurance policy construction exist so that there is predictability in the interpretation of such policies, which benefits both the insurer and the insured. In entering judgment against Penn National for almost $25 million, the trial court failed to adhere to these well-established canons, eschewing consistency in policy interpretation in favor of awarding the largest amount it could to the HOA and Portrait Homes. This Court cannot let the judgment stand.

An insured under an insurance policy has duties and obligations, including the duty to notify the insurer of a lawsuit, immediately forward process, and to cooperate. It is the insured's actions which govern this issue, not the insurer's. The trial court, however, by concentrating only on Penn National's conduct, essentially held that an insured can ignore these policy conditions with impunity and the insurer will be liable not only for the damages assessed in any underlying litigation, without having to allocate between covered and non-covered damages, but also for bad faith and punitive damages. The judgment in favor of the HOA cannot stand. Penn National respectfully requests that this Court vacate the judgment and enter judgment in favor of Penn National on all of the HOA's claims.

An insurance policy is to be construed according to its plain terms. Extrinsic evidence cannot be used to create an ambiguity that does not otherwise exist. The trial court, however,

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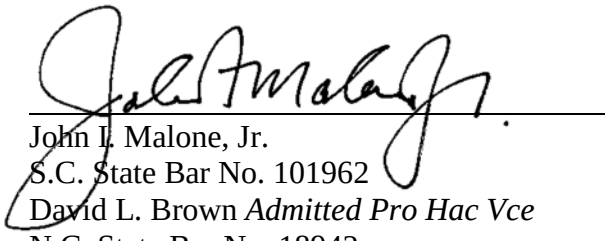
1695); Portrait Homes Proposed Order (RV p. 1751); Rule 59 Motion (RV p. 1818)] *Jones v. Lott*, 387 S.C. 339, 346, 692 S.E.2d 900, 903 (2010).

refused to interpret the Penn National Policies according to their plain terms. Instead, the trial court relied on extrinsic evidence to find that Portrait Homes was entitled to additional insured coverage and that Penn National's failure to provide such coverage constituted bad faith, justifying both bad faith damages and punitive damages in the amount of the entire settlement paid by Portrait Homes in the Persimmon Hill Litigation. Again, the judgment in favor of Portrait Homes cannot stand. Penn National respectfully requests that this Court vacate the judgment and enter judgment in favor of Penn National on all of Portrait Homes' claims.

December 14, 2020



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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM BERKELEY COUNTY
Court of Common Pleas

Roger M. Young, Sr., Circuit Court Judge

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Case No. 2014-CP-08-02757

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Portrait Homes – South Carolina, LLC and
Portrait Homes – Persimmon Hill, LLC; Plaintiffs,

v.

Pennsylvania National Mutual Casualty Insurance Company
and The Persimmon Hill Homeowners Association, Inc., Defendants,

AND

The Persimmon Hill Homeowners Association, Inc., Third-Party Plaintiff,

v.

Jose Castillo d/b/a JJA Framing and
JJA Construction, Inc. d/b/a JJA Framing, Third-Party Defendants,

Of which Pennsylvania National Mutual Casualty Insurance Company is the Appellant,

And

Portrait Homes – South Carolina, LLC, Portrait Homes – Persimmon Hill, LLC,
and The Persimmon Hill Homeowners Association, Inc. are the Respondents.

Appellate Case No. 2020-000735

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**CERTIFICATE OF COUNSEL**

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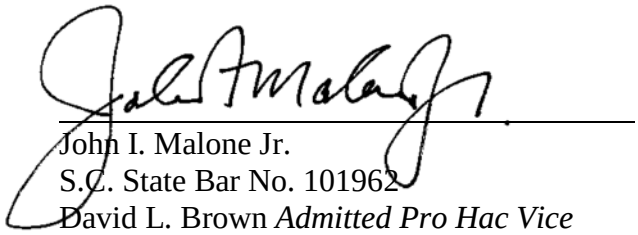
I hereby certify that this Final Reply Brief of Appellant complies with Rule 211(b) of the SCACR.

This the 14th day of December, 2020.



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