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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM BERKELEY COUNTY
Court of Common Pleas

Roger M. Young, Sr., Circuit Court Judge

Appellate Case No.: 2024-000820

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 Petitioner,

And

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

RETURN OF RESPONDENT THE PERSIMMON HILL HOMEOWNERS ASSOCIATION, INC. TO PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

In this construction defect matter, Judge Roger Young presided in an extensive nonjury trial. He made numerous findings of fact and rulings, which were affirmed by a unanimous panel of the Court of Appeals. No constitutional issue or novel question is presented. There is reference, in only two of the arguments advanced by Petitioner, to allegations that the Court of Appeals' decision conflicts with precedent from this Court. Not so. Judge Young and the Court of Appeals were careful to abide by this Court's precedents. Finally, the result in this case determined by Judge Young is emphatically correct. Here, the insurer received premiums, knew its policy was likely triggered in the large construction defect litigation for its insured, had a copy of the Complaint against its insured, and undertook the defense of the insured by obtaining an extension to Answer. The insurer then used an impromptu, unannounced oral discussion in the insured's open garage at his home with the insured, by a hired independent contractor, to claim that the insured knowingly decided to waive further insurance benefits, including further defense, to attempt to justify stopping further defense and allowing the insured to default. Judge Young found as a factual matter that there was no knowing waiver by the insured in this oral conversation, and that this conduct by the insurer was reckless and in bad faith. The petition for writ of certiorari should be denied.

STATEMENT OF THE CASE

This action arises out of two actions involving the Persimmon Hill townhome community brought by The Persimmon Hill Homeowners Association, Inc., Civil Action No. 2012-CP-08-3065, (hereinafter "HOA") and Cheryl L. Waker, on behalf of herself and others similarly situated, Civil Action No. 2012-CP-08-3066, (hereinafter "Class Claims") against Portrait Homes - South Carolina, LLC and Portrait Homes - Persimmon Hill, LLC, the developer and general contractor

(hereinafter collectively "Portrait") as well as against Portrait's subcontractors, including JJA Construction, Inc. d/b/a JJA Framing and Jose Castillo d/b/a JJA Framing (hereinafter collectively "JJA"). The HOA action involved construction defect claims related to the building exteriors and common elements, while the Class Claims involved claims related to townhome unit owners' individual damages.[1]

Following the filing of the underlying construction defect cases, Portrait filed this insurance coverage action, on December 29, 2014, against Pennsylvania National Mutual Casualty Insurance Company (hereinafter referred to as "Penn"), and other insurance companies, asserting that it was an additional insured under various insurance policies, that it was owed a defense in the underlying cases, and that it was owed the defense costs up to the date the insurers began defending Portrait in the underlying cases. On February 26, 2015, the HOA filed its Answer and bad faith crossclaims as the assignee of Portrait's bad faith claims against each insurance company.[2] All claims were resolved with all insurance companies other than Penn, and thereafter, on November 28, 2017, Portrait amended its Complaint to assert a cause of action against Penn for breach of the duty to defend and indemnify. The HOA filed crossclaims against Penn for the bad faith assigned from Portrait, and further, because the HOA had obtained a judgment against JJA, it obtained an assignment from JJA as to JJA's rights against Penn, including claims for bad faith against Penn.

All parties consented that all of the issues would be tried non-jury before the Honorable Roger M. Young, Sr. After hearing all of the trial testimony, Judge Young entered orders on October 22, 2019, in favor of Portrait and the HOA with a hearing for punitive damages to be held at a later date. (RI pp. 6-50, 51-107). On October 31, 2019, Penn filed a Rule 59 Motion. On

[1] The *Waker* case was not an issue in the trial or in this appeal.
[2] There was no issue regarding assignments in the trial nor is there in this appeal.

November 1, 2019, the HOA filed its election of remedies wherein it elected the Breach of Duty of Good Faith & Fair Dealing/Bad Faith instead of Breach of the Duty to Defend and Indemnify on JJA's assigned claims and elected also its Judgment Creditor Claim.[3] On January 15, 2020, Judge Young held the Rule 59 hearing, along with a punitive damages hearing. Following these hearings, judgment for Portrait and the HOA was entered on March 23, 2020. Penn's Rule 59 motion was denied. Punitive damages were awarded to both Portrait and the HOA, and judgment entered. Penn then appealed, and the Court of Appeals affirmed.

Penn opened a claim file in the underlying construction defect case on June 25, 2013, after receiving correspondence from Portrait's counsel tendering for additional insured coverage under JJA's policies. (RII pp. 611-613). This correspondence also contained a 450-page HOA's forensic engineer's report of the investigation of the Persimmon Hill project, along with the most recent amended complaint. *Id.* Penn assigned the claim to Greg Gross, an experienced claims adjuster with approximately 25 years claims experience. (RI p. 310, l. 15-p. 312, l. 1). Adjuster Greg Gross was supervised by Gary Gibson, the regional claim's office team leader of Penn's Greensboro, NC office. (RI p. 313, ll. 3-10). Also participating in the adjustment of the claims was Adam Parsons, Home Office–In House Claims Counsel. (RI p. 314, ll. 13-20, p. 320, l. 22-p. 321, l. 5). At the inception of the claim, Penn knew the claim related to the work of JJA was a multi-million-dollar claim. (RI p. 318, ll. 10-23, p. 359, ll. 4-7).

Penn's claims log contains the chronology of the claims from inception to conclusion. (RIII pp. 1179-1195, 1209-1225). On July 10, 2013, 15 days after the claims file was opened, the claims log memorializes a meeting between the primary adjuster, Greg Gross, Gary Gibson and Adam Parsons and notes Parsons' instructions on how the HOA claim against JJA and the Portrait tender

[3] Election of remedies regarding this point is not an issue in this matter.

for additional insured coverage should be handled. (RIII p. 1180). Gross as the frontline adjuster was charged with carrying out Parsons' claims handling instructions. (RI p. 322, ll. 2-13). Parsons instructed that if the named insured had not been served and/or had not requested a defense then Penn cannot retain counsel on their behalf. (RIII p. 1180). Additionally, Gross was to complete and submit a CQR (Coverage Question Report) to Parsons regarding Portrait's additional insured tender before any effort to investigate the claim or analyze coverage was undertaken. *Id.* CQRs are only submitted when there are coverage questions, and when it is more likely than not that the claim will be denied. (RI p. 322, ll. 19-23).

Penn's created requirement wherein an insured had to affirmatively request a defense prior to Penn hiring defense counsel is not contained anywhere in the policies. Gross testified that "when a lawsuit is filed against a Penn insured, they've got to do two things: Number one is the pleadings have to trigger coverage . . . . Then there is a second hurdle they've got to jump through which is, they got to request a defense from Penn . . . [.]" (RI p. 315, ll. 14-23). Gross testified that this second hurdle was not a term or condition contained in any of the insuring agreements that he had ever seen at Penn, and that he told management he believed imposing this requirement of specifically having to request a defense was improper. (RI p. 315, l. 24-p. 316, l. 23). Gross further testified that this second hurdle was not a requirement at any of the four (4) other insurance companies he had previously been employed at adjusting claims. (RI p. 317, l. 18-23).

Gross made an effort to locate JJA by doing an internet search but was unsuccessful and Gross determined that the insured was out of business. (RI p. 319, ll. 16-24). The claims file reflects that Gross did not use any of the insured's contact information contained in Penn's underwriting file available to him, which included two (2) phone numbers for Mr. Castillo, the phone numbers for the office manager and Glenda Castillo, and an email address. (RI p. 324, l. 1-p. 325, l, 23, RIII

pp. 1209-1225). Instead, Penn hired an Independent Adjuster ("IA"), Gayle McLeod, to go to the Berkeley County Courthouse to determine if JJA had been served. (RIII pp.1180, 1293-1294). The September 21, 2013, claims log entry reflects that as of that time the IA reported back to Penn that there was still no service on the insured. (RIII p. 1181).

On September 21, 2013, Gross sent by certified mail the first of three (3) Reservation of Rights ("ROR") letters to JJA Construction, Inc., to an incorrect address of 9496 Highway 78, Lot 2, Ladson, SC 29458, despite noting the correct updated address of 11227 Eastfield Rd, Huntersville, NC in the claims log entry that same day. (RIII pp. 1185, 1247-1252). The same day, the following plan was noted in Penn's claims log:

> PLAN: ROR has been sent to the insured today via certified mail. If the insured receives and requests a defense on these complaints, there is a probable defense obligation due to the negligence count in the complaint and the trigger of coverage in South Carolina. Diaried two weeks for acceptance of ROR. If letter comes back unclaimed will issue CQR[4] to HOC[5] for review of coverage (i.e., insured has not demanded a defense to date).

(RIII p. 1186).[6] The first sentence of the ROR states, "Penn National Insurance acknowledges receipt of the above referenced claim." (RIII p. 1247). The ROR stated that "construction defects appear to be resultant in water intrusion and deterioration as a result" and "[i]t appears from the contracts/purchase orders in the file that construction commenced in 2002." (RIII p. 1248). Penn noted the date of loss as December 5, 2003. (RIII p. 1247). The ROR was "cut and paste" correspondence that misapplied policy language for the Duty in the Event of an Occurrence Section

[4] CQR refers to Coverage Question Report. (RI p. 322, l. 14-p. 323, l. 7).
[5] HOC refers to Home Office Counsel, Adam Parsons. (RI p. 321, l. 3).
[6] In South Carolina, all contracts of insurance on property, lives, or interests are considered to be made in this State and are subject to South Carolina laws. S.C. Code Ann. § 38-61-10.

that was amended by an Extended Coverage Endorsement. (RI p. 327, l. 8- p. 328, l. 17). There was no claimed green card for this certified mail in the claims file. (RIII pp. 1179-1195).

The second set of ROR letters dated August 11, 2014, were sent by certified mail addressed to Jose Castillo d/b/a JJA Construction, Inc. and JJA Construction, Inc. (RIII pp. 1281-1286, 1287-1292). Both again contained the incorrect address of 9496 Highway 78, Lot 2, Ladson, SC 29458. (RIII pp. 1281, 1287). The second set of RORs also included language regarding Duties in the Event of an Occurrence that was different than the Duties in the Event of an Occurrence language contained in the policies. (RIII pp. 1281-1286, 1287-1292). There was no claimed green card for the August 11, 2014, RORs in the claims file. (RIII pp. 1179-1195). The third set of ROR letters dated October 2, 2014, were sent by certified mail to Jose Castillo d/b/a JJA Construction, Inc. One of the letters was sent to the outdated Ladson, SC, address, while the other was sent to the Huntersville, NC, address. (RIII pp. 1129, 1135). These RORs included language regarding Duties in the Event of an Occurrence that was also different than the Duties in the Event of an Occurrence language contained in the policies. (RIII pp. 1129-1134, 1135-1140). There was no claimed green card for this October 2, 2014, certified mail in the claims file. (RIII p. 1194). Penn's adjuster acknowledged that JJA never received this correspondence either. (RI p. 336, ll. 5-9). JJA was never informed by Penn that it was denying coverage. (RI p. 468, ll. 14-23).

The March 13, 2014, claims log note reflects the IA informed Penn that JJA had been served at the 11227 Eastfield Rd., Huntersville, NC 28078 address. (RIII p. 1187). After the independent adjuster informed Penn that JJA had been served, Penn's adjuster noted the following plan in the claim log on March 13, 2014:

> PLAN:
> I am going to have IA go to the home of the above and determine from the registered agent what their intentions are with this lawsuit. Are they requesting a defense? If no answer at that point, we have done everything

> we can do to discuss the case with the insured and will then issue a CQR requesting denial of coverage for defense of the lawsuit and the tender from the GC.

Id. The same day that Penn learned its insured had been served, Penn was discussing denying coverage. *Id.* Capstone ISG, the same IA, was next hired to complete an additional, but limited, task. The instructions given by Penn to Gayle McLeod at Capstone ISG were:

> 1) Make a cold call to the insured to inquire about suit representation,
> 2) Inquire if insured wishes that Penn National handle suit on their behalf.
> 3) Obtain contact information on Jose Castillo.

(RIII p. 1228). During this time while Penn had hired an IA to make a cold call on JJA to ask if JJA wanted these policy benefits to which it was already entitled, counsel for the HOA submitted notice of the claim to Penn by letter dated April 24, 2014, stating that no one had filed an Answer on behalf of their insured and that if no one filed an Answer within fifteen (15) days, an Order of Default and Judgment would be sought. (RIII p. 1230).

On the Saturday morning of May 10, 2014, Gayle McLeod made a cold call on JJA by showing up unannounced and walking into the open garage of Mr. Castillo's home in Huntersville, NC, knocking on his back door. (RI p. 427, ll. 14-19). According to McLeod, she spoke with him for ten (10) minutes. (RI p. 431, ll. 18-20). At the time of the cold call in Mr. Castillo's garage, he informed Penn that he had received the Complaint, and McLeod informed Mr. Castillo that Penn already knew about the case (Penn had a copy of it). (RI p. 442, ll. 8-17). Judge Young made a fact finding that Mr. Castillo did not knowingly and intelligently waive his rights to a defense in the litigation by Penn through this conversation. McLeod asked Mr. Castillo if he wanted Penn to defend him in the lawsuit to which he responded no. (RI p. 432, ll. 13-15, p. 472, ll. 2-6). However, this simple "no" must be put in context. Judge Young found that it would have been important to Mr. Castillo to have been told that he had already paid for a defense by paying policy premiums,

but he was never told this by McLeod. (RI p. 466, ll. 4-14). Further, Judge Young noted that McLeod did not provide any other relevant information to Castillo such as the details of the HOA's forensic engineer's report, his personal liability exposure being in the multi-millions of dollars, the cost of defense of the claims had already been paid for as part of the premiums, and that declining a defense would be rejecting a policy benefit that he was entitled to at no cost. (RI p. 332, ll. 10-25, p. 428, ll. 9-13, p. 445, ll. 11-14, p. 445 l. 25-p. 446, l. 3, p. 474, l. 12-p. 475, l. 2). McLeod did not provide this information to Mr. Castillo during the cold call because she was not asked to do so by Penn. (RI p. 333, ll. 13-17, p. 433, ll. 8-14, p. 437, ll. 4-7). McLeod did not make any effort to investigate the claim while with Mr. Castillo because she was also not asked to. *Id*. She had the opportunity to ask him about the Persimmon Hill project file, his scope of work, or anything else, but did not. (RI p. 443, ll. 2-19). McLeod did not take any recorded or written statement from Mr. Castillo. (RI p. 440, l. 23-p. 441, l. 5). Castillo testified he would not have answered her question "no" had he been given proper context and understanding. (RI p. 466, ll. 4-14).

Before this IA conversation, Penn ***undertook to provide a defense/protection to JJA by seeking and being granted a 30-day extension*** to file an Answer for JJA. (RIII pp. 1230, 1231). After the IA discussion, however, Penn abandoned the defense and received receipt of the entry of default on July 15, 2015, and the Judgment was entered on July 14, 2016, some twenty-six (26) months after Penn asked for the extension to Answer. (RIII pp. 1234-1236, 1240-1245).

As to Portrait's claim[7] and request for additional insured coverage from Penn, Portrait tendered for additional insured coverage by letter from its counsel dated June 5, 2013. (RII pp. 611-613). Portrait's counsel submitted a second tender dated May 23, 2014, since there was no

[7] The HOA incorporates herein the facts contained within Portrait Homes' Return.

response by Penn to the first tender letter. (RII pp. 616-617). Penn denied Portrait's request for additional insured coverage by denial letter dated September 30, 2014. (RII pp. 618-620). This denial letter was sent seventeen (17) months following the initial tender and is the only written correspondence from Penn to Portrait. The basis for the denial of Portrait's claim was ". . . the sole avenue to additional insured status would be through an endorsement providing additional insured status for completed operations. The above policies do not contain such an endorsement." (RII p. 619). The basis for denial was untrue, and this untruth was referred to by Greg Gross as "doesn't jibe"[8] and "not right"[9], by Adam Parsons as "inaccurate"[10] and by Penn's expert, Bernd Heinze, as "the opposite of what was true"[11]. Denial of additional insured requests were routine by Gross while adjusting claims at Penn. Gross believes that out of the twenty-five (25) to thirty (30) additional insured claims that he adjusted, he denied all of them, although Penn noted a single additional insured claim that Gross adjusted that was accepted. (RI p. 308, l. 16-p. 309, l. 10).

ARGUMENT

To satisfy the standard for this Court to grant certiorari, Penn must show there are special and important reasons for it to be granted. SCRCP 242(b). Such reasons may include (1) Where there are novel questions of law; (2) Where there is a dissent in the decision of the Court of Appeals; (3) Where the decision of the Court of Appeals is in conflict with a prior decision of the Supreme Court; (4) Where substantial constitutional issues are directly involved; and (5) Where a federal question is included and the decision of the Court of Appeals conflicts with a decision of the United States Supreme Court. SCRCP 242(b)(1)-(5). Penn's Petition seeks certiorari only

[8] RI p. 304, ll. 9-10.
[9] RI p. 358, ll. 23-24.
[10] RI p. 453, l. 11-p. 454, l. 8.
[11] RI p. 476, ll. 8-22.

under subsection (3). Further, Penn only does so via questions 1 and 3 in Penn's Questions Presented for Review. Contrary to Penn's assertion, the Court of Appeals' decision does not conflict with any prior decisions of this Court.

I. The Court of Appeals' Decision Does Not Conflict with this Court's Precedent When It Held Penn Breached its Duty to Defend

The Court of Appeals correctly affirmed the trial court's finding that coverage was afforded under eight (8) policies of insurance issued by Penn. The Court of Appeals correctly concluded that because Penn already had a copy of the Complaint (and had obtained an extension to Answer for JJA), Penn could not have been prejudiced by Castillo not sending them an additional copy of the Complaint. The Court thus concluded it "need not address whether the trial court erred in failing to find Castillo violated the notice and cooperation clauses." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 44). The Court of Appeals correctly stated "South Carolina has 'judicially adopted a notice-prejudice rule, whereby the insurer had the burden to show that it was substantially prejudiced by the failure of its insured to comply with the notice and cooperation provisions. This rule prevented an insurer from relying on an immaterial breach by its own insured as a defense to paying an injured third party.'" *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 44) (quoting *Neumayer v. Phila. Indem. Ins. Co*., 427 S.C. 261, 266-267, 831 S.E.2d 406, 408-409 (2019)). The trial court made findings of fact supporting that the alleged lack of notice and cooperation did not create substantial prejudice to Penn to include that Penn knew of this lawsuit before Castillo had been served, had the opportunity to respond to the suit, undertook a defense by seeking an extension to answer, and chose not to investigate when it had the opportunity while the IA met with Castillo in his garage. The Court of Appeals affirmed that Penn was not substantially prejudiced by the alleged lack of notice and cooperation.

Additionally, Penn now argues the Court of Appeals overlooked that it was further substantially prejudiced because of the entry of a default judgment despite it having a duty to defend its insured pursuant to its own policy language and its voluntary undertaking (and later improper abandonment of) that duty. Penn claims Mr. Castillo knowingly refused to allow Penn to hire counsel to defend him. Judge Young found as a fact that this did not occur. Further, the first time Penn ever raised this issue was well after the default judgment was obtained and only after the HOA sought to collect on the judgment, as noted in the trial court's order. This argument was never documented in its claims file, or anywhere else as a basis for Penn not hiring counsel.

a. <u>The facts in this case are the opposite of that of *Merit*, *Hatchett* and *Tucker*</u>

The facts in this case are unlike those in *Merit, Hatchett* and *Tucker* cited by Penn regarding substantial prejudice to an insurer. Here, Portrait, who is one of the insureds under the policies, advised Penn of the claims against JJA on June 5, 2013,[12] counsel for the HOA advised Penn of the claims against JJA and that JJA had been served on April 24, 2014,[13] and Penn's own IA had independently confirmed service and had a discussion about the lawsuit with Castillo in his garage in May of 2014.[14] Further, Penn acknowledges notice of the lawsuit in the ROR letters. All of these notices of the lawsuit to Penn from its insured Portrait, Plaintiff's counsel and its insured Castillo/JJA took place *prior* to the Order of Default being entered on December 16, 2014. (RIII pp. 1234-1236). In fact, Penn was aware that a default would be sought as set forth in the HOA counsel's correspondence dated April 24, 2014, for which Penn ***provided a defense/protection to JJA by seeking and being granted a 30-day extension*** to file an Answer for JJA. (RIII pp. 1230, 1231). Thereafter, Penn abandoned the defense and received receipt of the entry of default on July

[12] RII pp. 611-613.
[13] RIII p. 1230.
[14] RIII pp. 1232-1233.

15, 2015, and the Judgment was entered on July 14, 2016, some twenty-six (26) months after Penn asked for the extension to Answer. (RIII pp. 1234-1236, 1240-1245). Therefore, the facts between *Merit, Hatchett*, *Tucker*, and this case are diametrically opposite. Here, Penn knew of this lawsuit, began the defense by requesting an extension to answer and then made a conscious decision to abandon the defense and not protect its insured or itself, and therefore, was the architect of the circumstances that led to the default about which it now complains. Judge Young held that the default was a result of Penn's own actions and/or inactions and there was no substantial prejudice to Penn. (RI pp. 34-40, 133-136). The Court of Appeals affirmed, noting ". . . Penn National had opportunities, of which it did not take advantage, to at least attempt to protect itself." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 48).

By contrast, in *Merit*, it was undisputed that the suit papers were never forwarded to the insurance company. *Merit Ins. Co. v. Koza*, 274 S.C. 362, 364, 264 S.E.2d 146, 147 (1980). Moreover, the insured in *Merit* called his insurance company to let them know that his car was impounded. *Id*. The insurer was able to get his car back for him, and thereafter, didn't hear from anyone any further until *after* the default judgment was entered. *Id.* In *Hatchett*, the insurer didn't receive notice of the summons and complaint until after default was entered, and the Plaintiff refused to agree to lift the default therefore creating obvious prejudice to the insurer. *Hatchett v. Nationwide Mut. Ins. Co.*, 244 S.C. 425, 428, 137 S.E.2d 608, 610 (1964). Further, in *Tucker,* the insured actually did knowingly and voluntary relinquish his policy rights to a defense, but the facts in *Tucker* are in stark contrast to those here. *Tucker v. State Farm Mut. Auto. Ins. Co.*, 232 S.C. 615, 103 S.E.2d. 272 (1958). In *Tucker*, State Farm hired counsel to provide its insured a defense. When it was apparent that the insured was refusing policy benefits of a defense, counsel that had been hired by the carrier for Tucker provided a full explanation so as to ensure that any

relinquishment of policy benefits was knowing and voluntary. This Court noted the comprehensive nature and extent of information that counsel hired by the carrier provided the insured:

> The attorney repeated his former explanation of the necessity of defense of the action and of insured's verification of the answer; he explained the requirements of the policy that the insured cooperate in the defense, file answer, go to court, give evidence, etc.; but the insured was adamant in his refusal to sign the verification.

232 S.C. 615, 619, 103 S.E.2d. 272, 274. The Court of Appeals in its opinion in this case notes one of the distinctions with *Tucker* is that "the insured repeatedly told the attorney the insurer provided him that he 'had decided to have nothing to do with the action for damages against him; and he did not, which resulted in default judgment.'" *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 446) (quoting *Tucker*, 232 S.C. at 624, 103 S.E.2d at 277). Had Penn either hired counsel for JJA or provided full information as counsel did in *Tucker*, Castillo would have responded differently to McLeod and stated he wanted a defense, as testified to by Castillo at trial. (RI p. 462, l. 11-p. 463, l. 8, p. 466, ll. 4-14). And Judge Young so found at trial.

b. <u>The Court of Appeals Did Not Hold An Insured Cannot Decline Coverage</u>

Penn now also claims the Court of Appeals misapprehended the law and wrongfully misstates the Opinion of the Court by arguing the Court of Appeals held that an insured cannot decline coverage available to the insured under a policy of insurance. Not so. Contrary to Penn's assertion, the Court of Appeals did not hold that an insured ***cannot*** decline coverage, but rather reviewed the evidence and concluded that there was factual evidence supporting the trial court's findings that Castillo ***did not*** decline coverage. The Court of Appeals properly held, "[i]n the present case, evidence supports the trial court's finding Castillo did not decline coverage. Castillo's interaction with McLeod during the cold call in his garage did not amount to him declining coverage as Penn National contends; Castillo had a limited amount of information at the time of

that interaction." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 42). "[T]he trial court's findings of fact will not be disturbed on appeal unless wholly unsupported by the evidence or unless it clearly appears the findings were influenced or controlled by an error of law." *Butler Contracting, Inc. v. Court Street, LLC,* 369 S.C. 121, 127, 631 S.E.2d 252, 255-56 (2006).

c. Penn Had Insured's Consent for Representation Through the Terms of the Insurance Policy and Didn't Raise Lawyer Ethical Considerations in Providing a Defense Until Persimmon Hill Sought to Collect Judgment

The issue of lawyer ethical concerns was never any part of Penn's decision to not provide it's insured a defense. Nowhere in any of Penn's file material to include its detailed claims log or ROR letters did it ever raise this issue of not providing a defense to Castillo because of lawyer ethical considerations until after the default judgment was obtained and the bad faith claims were being litigated. Penn argues that they could not provide a defense because a lawyer is ethically prohibited from representing a client without his consent for representation, and this resulted in the default. Penn ignores the consent for representation and its contractual agreement for Penn to provide representation for JJA already exists in the insuring agreement: "We will have the right **and duty** to defend the insured against any "suit" seeking those damages. . . ." (RII pp. 653, 717, 784, 860, 924, RIII pp. 981, 1043, 1096)(emphasis added). Furthermore, this Court has provided the following in regard to the intricacies between the insurer, insured, and defense attorney:

> [A]n insurance company that hires an attorney to represent its insured is in a unique position in relation to the resulting attorney-client relationship. Pursuant to the insurance contract, the insurer has a duty to defend its insured, and must compensate the attorney for his time in defense of his client. If the insured settles or has judgment imposed against him, the insurance contract ordinarily requires the insurer to pay the settlement or judgment. Many insurance contracts provide the insurer has a right to investigate and settle claims as a representative of its insured. Finally, the insurer's right to settle must be exercised in good faith, and that duty of good faith requires the insurer to act reasonably in protecting the insured from liability in excess of the policy limits.

Sentry Select Ins. Co. v. Maybank Law Firm, LLC, 826 S.E.2d 270, 272 (S.C. 2019)(citing *Tyger River Pine Co. v. Maryland Cas. Co.*, 163 S.C. 229, 234-35, 161 S.E. 491, 493-94 (1931)).

The two issue rule is applicable regarding this argument. Judge Young specifically ruled that this basis asserted by Penn for failing to defend JJA, namely – a supposed requirement that the insured affirmatively approve the hiring of the attorney before the attorney could act – was not mentioned in any ROR letters by Penn and was therefore waived. *See* RI p. 135("This argument from Penn National is not part of any reservation of rights letter and not contained anywhere in its claim log."); *Harleysville Group Ins. v. Heritage Cmtys., Inc.*, 420 S.C. 321, 339, 803 S.E.2d 288, 298 (2017) (holding that grounds for avoidance of duties under an insurance policy must be provided via ROR letters or such will be deemed waived). Penn did not appeal this ruling and it is thus the law of the case. "Under the two issue rule, where a decision is based on more than one ground, the appellate court will affirm unless the appellant appeals all grounds, because the unappealed ground will become the law of the case." *Jones v. Lott*, 387 S.C. 339, 346, 692 S.E.2d 900, 903 (2010)(citing *Anderson v. Short,* 323 S.C. 522, 525, 476 S.E.2d 475, 477 (1996)).

Further, the Court of Appeals, after reviewing the findings of the trial court regarding consent to representation, completing an extensive analysis of South Carolina case law on this topic and noting the South Carolina Bar Ethics Advisory opinion, while instructive, was not binding and not the sole basis for the court's decision, held " . . . as Penn National never attempted to hire an attorney for Castillo, we are unpersuaded by its assertion it was prejudiced because it could not ethically do so." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 49).

Thus: 1) the trial court's unappealed waiver ruling regarding this issue; and 2) the Court of Appeals' holding that Penn never sought to retain an attorney in any event (a holding also not challenged by Penn on rehearing or in Penn's certiorari petition), and 3) that the Policy terms

permit the carrier to hire the attorney for the insured, amply justify denial of the petition for writ of certiorari and any asserted need by Penn to further explore this issue (Question 1) by this Court.

II. The Court of Appeals' Decision Regarding Damages Does Not Conflict with this Court's Precedent

Penn argues that coverage under its policies is not afforded for all damages awarded to the HOA. Yet, the HOA and Portrait Homes presented substantial evidence regarding damages covered by Penn's policies, and the amount thereof, through the testimony of engineer Robert G. Sisnroy, P.E., and J. Blanton O'Neal, IV, counsel for Portrait Homes in the underlying case. JJA's scope of work included the installation of the windows, window flashings and weather barrier on approximately 85% of the 388 townhomes in the Persimmon Hill project, and JJA was the biggest subcontractor on the job –as is generally the case on a job of this type– and "their work is integrated throughout the project." (RI pp. 95, 97). Mr. Sisnroy testified that there were approximately 4,000 windows installed in this project, and he did not find a single window location to be without problems. (RI p. 94). He also testified that the rot caused by the water damage resulted in the oriented strand board (OSB) becoming so deteriorated that it could be removed by hand. *Id.* He further found that the rot extended beyond the OSB and into the structural members of the building and found this condition to be pervasive. *Id.* There was such a massive amount of water entering through the window-wall intersection that even curtains and plantation blinds were damaged. *Id.*

The trial court found as a factual matter that "JJA's faulty work in installing windows, window flashings, and weather barrier caused water intrusion and resulted in damage to non-defective wood walls, structural members, drywall, trim, curtains and plantation blinds." (RI p. 38). It further held that "the damage to non-defective work constituted physical injury to tangible property satisfying the definition of 'property damage' in the Penn National policies." *Id.* at 38-39. The trial court heard testimony from J. Blanton O'Neal, IV, who "estimated approximately 50

percent of the plaintiffs' repair estimate of $12,700,000 was for repairing non-defective work that was damaged by JJA Framing's defective work." (RI p. 97). Therefore, the total covered damages according to the testimony of O'Neal is approximately $6,350,000. This damage to non-defective work resulting from JJA's defective work was described as well by Mr. Sisnroy as being pervasive throughout the Persimmon Hill project. (RI p. 38). Penn put up no evidence to dispute the testimony of Mr. Sisnroy or Mr. O'Neal. The trial judge did not ignore the issue of covered damages verses uncovered damages as Penn contends. Penn's assertion is contrary to the uncontradicted testimony of O'Neal that damage from JJA's defective work was to non-defective building components and the trial judge found as a fact that the covered damages exceeded Penn's policy amounts. (RI pp. 46-49). The Court of Appeals decision here was thus in conformity with this Court's decision in *Builders Mut. Ins. Co. v. Island Pointe*, 431 S.C. 93, 847 S.E.2d 87 (2020).

Further, Penn failed to preserve arguments regarding partial coverage by sending its cut and paste ROR letters to a four-year-old stale address and admitting that Castillo never received any of the three ROR letters issued by Penn. (RI pp. 16-17, 43). Penn further could have had its ROR correspondence provided to Mr. Castillo by Gayle McLeod when she went to his home but chose not to. This Court was clear in *Harleysville* as to the requirement and purpose of an insurer informing its insured of the coverage defenses it may assert through ROR letters. *Harleysville Group Ins. v. Heritage Cmtys., Inc.*, 420 S.C. 321, 339, 803 S.E.2d 288, 298 (2017). The Court in *Harleysville* defined an ROR as the following: "A 'unilateral reservation of rights' is a notice given by the insurer that *it will defend* [the insured in the lawsuit] but reserves all rights it has based on noncoverage under the policy . . . ." *Id*. at 338, 803 S.E.2d at 297(quoting 14 Couch on Ins. § 202:38)(emphasis added). If a carrier does not adequately reserve its rights sufficiently specifying its coverage defenses through a proper ROR, then the carrier will be precluded from disputing

coverage at a later time. 420 S.C. at 339, 803 S.E.2d at 298. The trial court held that "Penn National had the opportunity to defend its insured but chose not to even after requesting a 30-day extension from Plaintiff's counsel to file an answer after its insured had been served. . . . Penn National had the opportunity to seek allocation of damages if it had provided a defense and participated in the underlying litigation on behalf of JJA." (RI p.142). Therefore, Penn's erroneous and belated request for apportionment should be denied.

Penn further contends that the Court of Appeals misapprehended this Court's decision in *Crossmann Cmtys v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (2011) ("*Crossmann II")*. This argument is without merit. The facts in *Crossman II* were stipulated whereas the facts in this case were not stipulated but rather the allegations in the underlying complaint were admitted because of the default. The carriers in *Crossman II* provided a defense for their insureds whereas here an extension was obtained, and the defense was then abandoned by Penn. There was testimony here as to the extent of damage repairs being necessitated as of 2012 per Robert G. Sisnroy, P.E., whereas there was no testimony of an end date to the risk period in *Crossman II*. This case involves Penn as the sole carrier for the entire risk period while *Crossman II* had more than one carrier. Also, the policy language in *Crossman II* is different from the policies here.

As noted by the Court of Appeals, the *Crossmann II* formula "is not a perfect estimate of the loss attributable to each insurer's time on the risk. Rather, it is a *default rule* that assumes the damage occurred in equal portions during each year that it progressed." *Crossmann II* at 65, 717 S.E.2d at 602. The Court of Appeals observed that this Court ruled in *Crossman II* that the formula "is subject to alteration *at the discretion of the trial court*." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 67) (quoting *Crossmann Communities of North Carolina, Inc. v. Harleysville Mutual Insurance Co.*, 411 S.C. 506, 522, 769 S.E.2d 453, 462 (Ct. App. 2015)). The Court of

Appeals concluded that the trial court did not err in its damage calculation because the trial court found the change in policy language meant the time on risk analysis changed as well, such that "the progressive property damage caused by continuous or repeated exposure to water intrusion occurring *after* the end of a policy period is deemed to be included in what is covered by the policy." (RI p. 100). In addition to the testimony regarding the water intrusion damages, the Amended Complaint in the underlying action, which was deemed admitted when Penn let its insured go into default, provided, "Each year since completion new areas of damage occurred, separate and apart from any damage already in progress of occurring." (RII p. 551). Therefore, it was ***admitted*** that new damage occurred in different policy years that was not already in the process of occurring and/or ongoing in the previous policy year(s), supporting that each policy year of coverage was triggered as found by the trial court rather than a single policy year as Penn contends.

Penn made the decision to gamble with Mr. Castillo's assets by not providing Mr. Castillo a defense and allowing a default judgment. Penn cannot now claim it should reap the benefits and protections of the default time-on risk formula in this context. Penn is seeking to benefit itself to the detriment of its insured by allocating the pro-rata uninsured period of time portion of the judgment to its insured when such allocated amount may have been reduced by defending the claim. This, though, would have required Penn to perform its obligations. "An insurance company fails to defend at its own peril. . . ." *Stroup Sheet Metal Works, Inc. v. Aetna Cas. & Sur. Co.*, 268 S.C. 203, 212-13, 232 S.E.2d 885, 888 (1977). "Where an insurer refuses to undertake the defense of an action against the insured based upon a claim within the coverage of the insurance policy, it thereby breaches the contract of insurance and is liable to the insured for all damages resulting to such insured as a direct result of such refusal and breach." *Fuller v. Eastern Fire & Casualty Ins. Co.*, 240 S.C. 75, 89, 124 S.E.2d 602, 610 (1962)(citations omitted). Further, "[a]n insurer who

unreasonably refuses or fails to settle a covered claim within the policy limits is liable to the insured for the entire amount of the judgment obtained against the insured regardless of the limits contained in the policy." *Doe v. S.C. Med. Malpractice Liab. Joint Underwriting Ass'n*, 347 S.C. 642, 649, 557 S.E.2d 670, 674 (2001)(citing *Trotter v. State Farm Mut. Auto Ins. Co.*, 297 S.C. 465, 475, 377 S.E.2d 343, 349 (Ct. App. 1988)). Accordingly, the Court of Appeals' decision did not conflict with this Court's precedent and the writ of certiorari as to Question 3[15] should be denied.

III. The Court of Appeals' Decision Regarding Bad Faith Does Not Conflict With This Court's Precedent

Penn argues that the HOA and Portrait failed to prove the causal link between the denial of benefits and the bad faith conduct by Penn. In addition, Penn argues that it had a reasonable basis for its decisions, and therefore, the bad faith ruling should be reversed. It further argues that there were no damages suffered from Penn's bad faith. These arguments are without merit. The trial court identified (both individually and collectively) Penn's unreasonable actions in breach of the implied covenant of good faith and fair dealing that resulted in the denial of policy benefits (RI p. 140), which was correctly affirmed by the Court of Appeals.

As it pertains to the HOA as assignee of JJA and Mr. Castillo's bad faith claims, the trial court found "Penn National required Mr. Castillo to specifically request a defense from Penn National prior to Penn National hiring counsel to provide a defense irrespective of whether the Complaint triggered coverage." (RI p. 137). The claims file is replete with claim notes that Mr. Castillo would not be provided a defense until he affirmatively requested one. (RIII pp. 1180,

[15] Question 2 of the Petition will be addressed primarily by Portrait, and the HOA adopts its position regarding that question and incorporates its position into this Return. The writ as to Question 2 should be denied.

1181, 1186, 1187). Judge Young, as fact finder, reviewed the evidence and witnessed the demeanor of the witnesses, including the Penn witnesses. The trial court's finding that Penn acted in bad faith, and recklessly so, is supported by the evidence and reasonable inferences, therefrom. The trial court found that Penn was manufacturing reasons it knew were not in its policy to try to justify a denial of the defense and coverage here which resulted in a default judgment against JJA and Castillo. Also, the fact Penn undertook the defense/protection in obtaining an extension for the time to respond to avoid default for JJA pursuant to its policy duty, ***before*** speaking directly with Mr. Castillo, completely undermines any supposed basis Penn had for first needing to have Mr. Castillo "request" a defense (to which he was already entitled under the policy), prior to taking action to defend him. *See Byerly v. Connor*, 307 S.C. 441, 445, 415 S.E.2d 796, 799 (1992) (where "an act is voluntarily undertaken, the actor assumes a duty to use due care.").

The trial court further found Penn and Gayle McLeod misled Mr. Castillo by providing him limited and incomplete information during the Saturday morning cold call in the garage at his residence when asking Mr. Castillo if he wanted a defense. There is clearly a causal link between Penn National's denial of benefits and its bad behavior (e.g., asking Mr. Castillo misleading questions) and the outstanding default judgment. The trial court found as a matter of fact that "Penn National knowingly misrepresented to JJA the coverages and policy benefits . . . by failing to disclose pertinent facts and information"; that "Penn National put its interests ahead of its insured by asking JJA whether it was requesting the valuable policy benefit of a defense to which it was already entitled. If the answer is yes then Penn National must do what it is already obligated to do, but if the answer is no then Penn National attempts to avoid potentially paying a claim of millions of dollars to an innocent third-party claimant"; and that the "conduct of Penn National was unreasonable, in bad faith and in breach of the duty of good faith and fair dealing to its insured."

(RI p. 45). Therefore, Penn's assertion that its decision to deny coverage was based on reasonable grounds was found to be factually inaccurate by the trial judge, which finding is supported by the evidence. Thus, the Court of Appeals correctly affirmed.

Penn further alleges that the trial court and the Court of Appeals failed to analyze the damages caused by Penn's bad faith conduct. Contrary to Penn's assertion, the trial court found as a factual matter that but for its bad behavior, the default judgment would not have been entered: "As a result of Penn National's failure to provide JJA a defense, an Order of Default was entered against JJA on December 22, 2014, nearly nineteen (19) months after being put on notice of the lawsuit. (HOA Ex. 12). Penn National was also put on notice of the entry of default by correspondence dated July 1, 2015, from HOA's Counsel[.] (Pl. Ex. 58, 17; HOA Ex. 12)." (RI p. 164). Penn undertook to seek an extension to file an Answer to the HOA Complaint and had an opportunity to fully protect and defend its insured. Yet, it ultimately chose not to do so based, according to Penn, on an oral conversation in the insured's garage, the contents of which conversation the trial judge found to be in bad faith. "Over a year later, on July 13, 2016, a Default Judgment was entered against JJA in the amount of $4,156,976.89 by the Honorable Dale Van Slambrook. (HOA Ex. 13)." (RI p. 164). Instead of protecting its insured's interests, Penn solely looked out for its own interests in bad faith, and allowed its insured to go into default, when it easily could have prevented that outcome.

In affirming the trial court's findings related to Penn's unreasonable conduct, the Court of Appeals specifically notes some of the evidence supporting the trial court's finding of bad faith, "Penn National's failure to investigate; its failure to check its own records for Castillo's contact information; its knowledge Castillo never received any of its RORs; its application of terms not in the policy (requiring Castillo to request a defense); and its not informing Castillo of all the pertinent

information known to it about the claim." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 52). Therefore, the Court of Appeals properly affirmed the trial court's ruling of bad faith as it pertains to the HOA as assignee of JJA's claims against Penn.

As to Portrait, the trial court held Penn owed Portrait a duty of defense based on the allegations in the underlying complaint which caused damages to Portrait, and that Penn acted in bad faith in its breach of such duty. (*See* RI pp. 93-106, 127-129). The basis for denial of Portrait's claim as set forth in Penn's letter dated September 30, 2014, was ". . . the sole avenue to additional insured status would be through an endorsement providing additional insured status for completed operations. The above noted policies do not contain such an endorsement." (RII p. 619). This basis for denial was simply false, as noted above. Therefore, the trial court held as a matter of fact that Penn's basis for denial was unreasonable. The trial court found that Portrait suffered damages for this breach of the duty to defend. (RI p. 124, 129, 156). As noted below, Penn's complaints and arguments about punitive damages regarding this breach and bad faith conduct is without merit, and unpreserved in any event.

In affirming the trial court's findings related to Penn's unreasonable conduct, the Court of Appeals specifically noted some of the evidence supporting the trial court's finding of bad faith, which included failing to respond for seventeen months, which Penn acknowledged was untimely, providing an inaccurate reason for denying coverage to Portrait Homes, and failing to reasonably investigate Portrait's request for additional insured status. *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 64-65). Therefore, the Court of Appeals properly affirmed the trial court's holding of bad faith damages as it pertains to Portrait. The Petition should thus be denied as to Question 4.

VI. As to Appellant's Arguments Regarding Punitive Damages

Penn argues there was no evidence that any alleged conduct by Penn rose to the level of willful conduct or even evidenced a reckless disregard of the insured's rights. Penn asserts that the Court of Appeals merely found that the evidence supporting a bad faith claim was sufficient to also support a claim for punitive damages. This is without merit. As noted by the Court of Appeals, "[m]any of the trial court's findings that support its bad faith determination also support its determination that Penn National's conduct was willful and reckless." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 65). The facts that give rise to punitive damages were exhaustively argued to Judge Young, and much of the trial transcript quotes supporting these arguments are contained in the PowerPoint presented at the Rule 59(e) hearing and filed with the trial court when the trial court held a separate hearing to determine the amount of punitive damages. (RV pp. 1832-1899). The trial court determined that Penn had acted in bad faith from the evidence presented at trial prior to the subsequent punitive damages hearing. (RI p. 49). Judge Young also found by clear and convincing evidence that Penn had engaged in recklessness and that punitive damages should be awarded. (*See* RI pp. 150-177). The subsequent punitive damages hearing was held, Judge Young set forth his reasons and findings justifying fully his award amount of such damages, and Penn filed no Rule 59(e) motion challenging his basis. Hence, Penn's punitive damages challenge is unpreserved. Regardless, the Court of Appeals further enumerated some of the instances that warranted the imposition of punitive damages in favor of the HOA to include: "Penn National t[aking] a position unsupported by the policies or law that Castillo had to request a defense before it would provide one to him, despite the fact that his policies and his payments entitled him to one." *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 54). In addition, the Court of Appeals noted that it appeared from Penn's own expert's testimony that Penn has engaged in similar behavior before. *Id.* The Court of Appeals further enumerated some

of the instances that warranted the imposition of punitive damages in favor of Portrait including Penn taking seventeen months to respond with an incorrect reason for denying coverage without reviewing its underwriting file. *Portrait Homes*, Op. No. 6038 (Howard Adv. Sh. No. 48 at 65). Further, "Penn National internally indicated it was likely going to deny coverage two months before any coverage analysis took place." *Id.*

Penn further argues that the HOA and Portrait should have been required to elect their remedies between damages from their bad faith claim and punitive damages. This argument is unpreserved. Penn made no Rule 59(e) motion with regard to the Judge's comprehensive Order setting punitive damages, which extensively set forth the reasons therefore and facts supporting same. (*See* RI pp. 150-177). Further, in South Carolina "if [the insured] can demonstrate the insurer's actions were willful or in reckless disregard of the insured's rights, he can recover punitive damages." *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983). Therefore, no election of remedies is required in any event. Thus, the petition as to Question 5 should be denied.

Portrait will address Question 6 of the Petition in its Return, and the HOA hereby adopts Portrait's positions relating thereto and incorporates those herein.

CONCLUSION

For the reasons stated herein, this Court should deny Petitioner's Petition for Writ of Certiorari.

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